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DEVELOPMENT OF ECONOMIC INTELLIGENCE:
OFFICE OF ECONOMIC RESEARCH

VOLUME III
1967 - 1972

by



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OER 3
October 1974
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OFFICE OF ECONOMIC RESEARCH

VOLUME III
1967 - 1972

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Chapter I

THE ESTABLISHMENT OF OER

"Good order is the foundation of all good things."

Edmund Burke

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~~SECRET~~A. The World Scene in 1967

The world scene in 1967, when the Office of Economic Research (OER) was created, was vastly different from that at the birth of the Office of Research and Reports (ORR) 17 years earlier. While the Soviet Union remained the only power that could realistically pose a threat to US national survival and thus remained the major target of intelligence concern, the economic intelligence interest in that country had developed along unforeseen lines. With assessments of the Soviet military posture now conducted by ORR's other offspring, the Office of Strategic Research (OSR), consideration of the Soviet economy by OER was focused on its progress in the growth race, its economic aid and trade policies and programs in the international area, and its changing economic relationships with other countries of the Communist World.* Communist China was of greater concern

* OER also continued to play a major role in estimating the costs of Soviet military programs.

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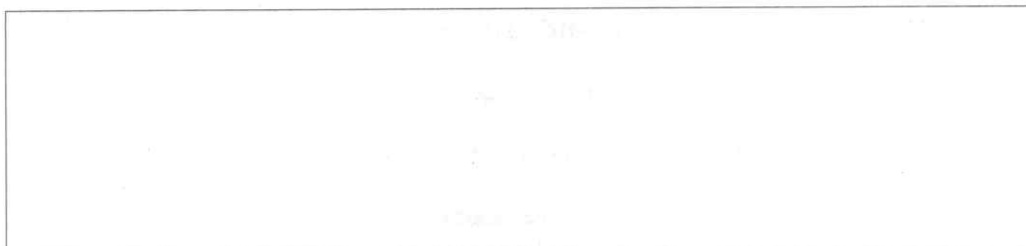
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than it had been in 1950, when it was regarded primarily as a Soviet satellite and in certain respects a liability to overall Communist strength. China's "Cultural Revolution" in 1966-69, coming on top of the Sino-Soviet split and the economic declines of the earlier years of the decade, presented a picture of disorder and even disintegration in both political and economic spheres. Nevertheless, the Chinese nuclear and missile developments were regarded as a potential threat to China's neighbors and ultimately to the United States, while the troubled conditions in the rest of Asia, highlighted by the Vietnam war, were regarded as directly related to the China threat. Concern about the Communist-led threat to stability in this area continued to be widespread, even though it had recently received a major setback in Indonesia. The tensions and rivalries in the Asian sub-continent and in the Middle East, while they had certainly existed in the early 1950's, had not then been considered within the purview of ORR. By 1967, however, the growing acceptance of the Office as the government's major economic intelligence arm had seen these trouble

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spots become of significant concern to the Office, as were the problems of economic development -- or more typically stagnation and disorder -- in Africa and Latin America. These concerns were manifest in responses to the crisis situations and the decisions which economic and political change continually placed before the US government's policymakers with respect to individual countries around the globe. In addition the Office was beginning to play a support role with respect to such international problems as population pressure, social and economic inequality, the revolution in agricultural technology, the raw materials and energy shortages, and the growing gap between rich and poor nations.

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These events carried their own set of policy problems, which would involve the new Office in fields far removed from the simple weighing of economic strengths and weaknesses in a limited number of potential enemy countries. These would include not only US relationships with individual

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countries but also international problems of monetary stability, balance of payments, and the adequacy of traditional international financial mechanisms for handling increasing world trade.

In the light of these world conditions, it is not surprising that the organization of the new Office, which at its inception still reflected the traditional concerns of the Economic Research Area of ORR, was very early in its first year subjected to critical review.

B. The Reorganization of 1967

Initially, OER consisted of all former ORR components -- less the Military-Economic Research Area [redacted] The four continuing divisions and four supporting staffs were directly subordinate to the Director's Office without the interposition of an area level of control (see Figure 1). The Communist Division concentrated on aggregative analysis of the Communist countries [redacted] while the General Division worked on the non-Communist countries [redacted] The Trade and Services Division and the Resources and Industries Division provided intelligence on the various economic sectors -- primarily of

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Communist countries, but with support on Free World countries as required.

It soon became evident that this organization did not reflect the responsibilities -- expressed or tacit -- that were being laid on the new Office as a result of the world situation described above. The Office was, in fact, facing for the first time an organizational problem that had been identified fairly early in intelligence literature. In 1949, Sherman Kent had initially posed the question, "Should the basic pattern of intelligence organization be regional or functional?" 1/* This organizational dilemma -- caused by the concern with foreign nations as political and economic regional units on the one hand and with economic phenomena as functional activities on the other -- had not been too serious for ORR as long as it was focusing on a limited number of countries, which tended to -- or were believed to -- coordinate their activities under central guidance, i.e., the Sino-Soviet Bloc. With the developing independent course of those

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countries and with ORR's concern widening to cover the Free World, the problem became acute.*

Under the four divisional organization inherited from ORR, the regional versus functional dilemma was being met with a compromise arrangement: two geographic and two functional divisions as described above. Work on Vietnam was, for example, divided with the strictly economic assessments of

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North and South Vietnam made by the Indochina Branch of General Division, and the bomb damage, logistics, and military manpower studies were carried out partly by a Special Projects Task Force within Trade and Services Division and partly by the Construction and Transportation Branches in the same Division.

As [] saw the problem, reorganization to meet the growing burden of Vietnam research was the most acute requirement, but the need to achieve a geographic orientation for Office activities spread across the board. He regarded the intelligence problem as "first geographic and second functional.* 2/ An additional problem that concerned [] was the inadequate provision for substantive guidance and review since the elimination of the Area echelon, which occurred when the Military Research Area was transferred out and the Economic Research Area was abolished.

In order to remedy these weaknesses, [] proposed in August 1967 to reorganize the Office

* Kent, in discussing this basic dilemma in 1949, had also opted for an essentially regional pattern. 3/

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into five divisions divided into two areas (see Figure 2). The Communist Research Area's (CRA) two divisions had responsibility for the continuing effort on this office's traditional targets: the USSR and Eastern Europe in one and Communist China in the other. In the International Research Area (IRA) were: the Indochina Division, which concentrated work on the Vietnam war and the Indochina peninsula generally in one division; the Free World Division whose Branches [REDACTED]

[REDACTED] and the International Services Division which was assigned responsibility for research on services and other activities which transcended national and regional boundaries. 4/ This proposal was approved by the DDI and put into effect on 1 November 1967. It provided the basic organizational structure, with some later changes at the branch level, for OER until 30 June 1972 where another major reorganization occurred.*

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The new organization represented more than an adjustment to changing substantive requirements. The reduction of functional branches from 13 to 10 and the subordination of most of these to a regional

* See pp. 232-235.

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organization at the division level represented not only an overdue shift in attitude toward the substantive demands upon the Office, it required also a change in attitude on the part of many of the individuals involved. Any shakeup of personnel can carry the seeds of morale damage and other personnel problems. Although the 1967 reorganization was not as serious in this respect for OER as had been the 1953 shakeup which had wiped out the Strategic Division,* there were adjustment problems. The change in work assignments meant for most of the Office's functional specialists a reordering of their priorities and interests, which was in some cases not easy. Although the change was often wrongly interpreted as a downgrading of their importance, much of this feeling was dispelled when it became apparent that efforts were being made to provide a degree of unity to functional research activities. One of these was the designation of experienced functional analysts as "senior technical advisers." These individuals were to have not only regular line responsibilities within the Divisions but also to play consultative

* See Volume I, pp. 83-87.

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roles on the more complex functional studies and on technical questions as they might be required by analysts of any branch. In addition, they would serve as the Office's points of contact with such specialized government agencies [redacted]

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[redacted] Finally, they were to serve as advisers on the training of additional functionally specialized analysts. These assignments have served the dual purpose of maintaining the morale and making the most effective use of the technical and functional specialists who have been able to adjust to the changing mission of the office.

C. The End of Annual Program Planning

It was also in the first year of OER's existence that another significant change took place in the management of economic research. This was the abandonment of the annual research program. Since the days of [redacted] (1951-52) the annual research planning exercise had been an important office ritual.* Every spring each branch had been required to draw up at some length a schedule of its commitments, known and anticipated, and of

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* See Volume I, pp. 89-92 and 97-112.

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its research gaps. These were brought together in a program of planned research projects to meet these commitments and gaps -- each project was described in detail in the annual program with an estimate of the necessary man-hours and due dates. By the mid-1960's, however, unanticipated policy support was crowding in increasing number of planned projects off the schedule, and the elaborate annual planning exercise was more and more an exercise in frustration. The program prepared for FY 1968 contained a tacit recognition of this in its breakdown of self-initiated projects into two categories:

- (a) Almost certain to be undertaken and
- (b) May be undertaken.

Even these categories proved too sanguine. Early in 1968 a cursory check showed that few projects in either category were going to be completed -- for some branches none had even been started. Without fanfare the annual program planning exercise was abandoned. Each branch and division was thereafter charged with the continual updating and review of its research priorities, and new projects were laid on as the need arose.

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Periodic staff meetings at the area and Office level proved to be a more realistic means of command-line monitoring of research and reporting activity, and the resultant gain in flexibility was a necessary factor in the Office's capability to respond to policy requirements. A less happy result was perhaps the further neglect of basic research. But this was in any case inevitable given the demands on the Office for current policy oriented studies. Basic research, however desirable and necessary, had not for some years been on the scale believed necessary by []

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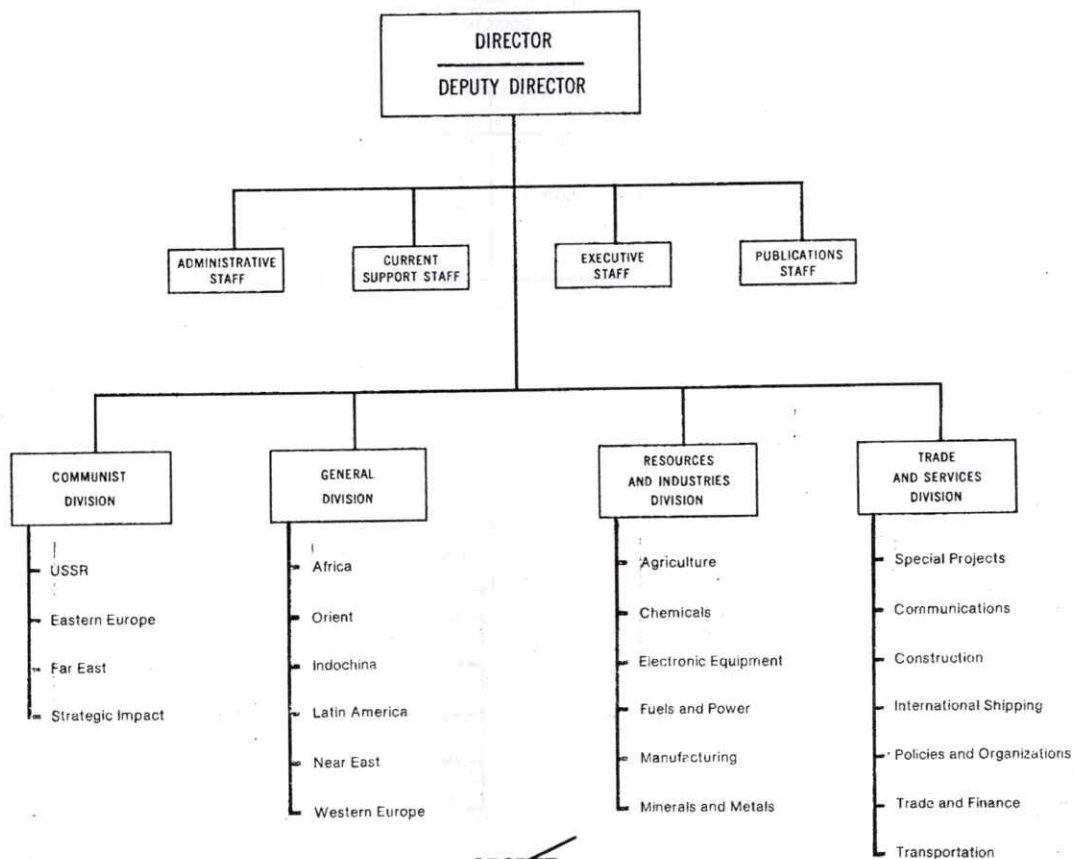
[] and other Office leaders. The new approach to project initiation (and completion) was at least more realistic and less frustrating than annual programming had come to be.

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Figure 1



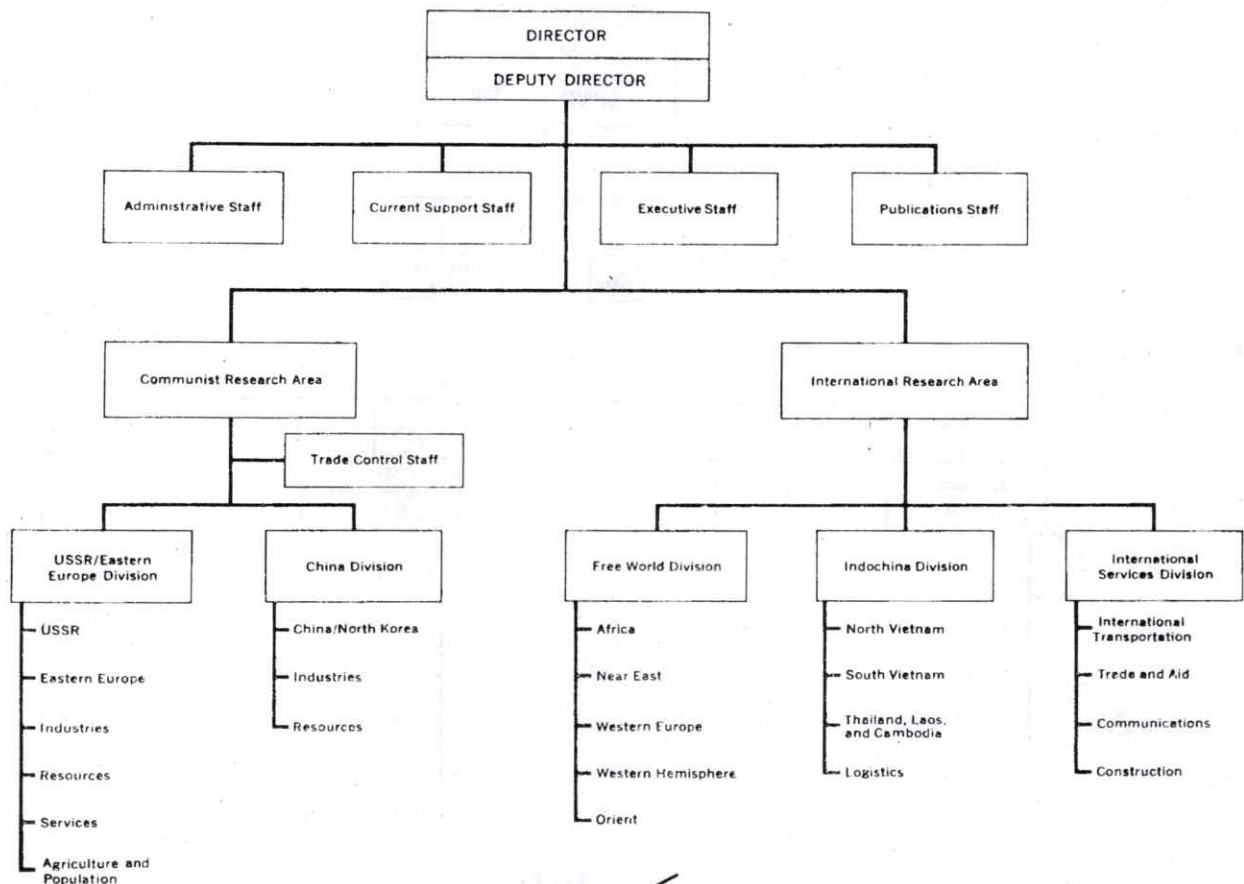
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OFFICE OF ECONOMIC RESEARCH

Figure 2



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~~SECRET~~**Chapter II****NEW LEADERSHIP AND NEW DIRECTIONS**

"...the age of chivalry has gone. That of sophisters, economists, and calculators has succeeded."

Edmund Burke

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(b)(6)A. [] Becomes D/OER

On 2 January 1968, [] took over
as Director of the Office, []

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appointment(b)(1)
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meant that for the first time since []
tour (1951-52) a professional economist was head-
ing the Office. It also put in formal charge the
man who had in fact directed the economic research
effort for fifteen years, i.e. since May 1953,
when [] came to the Agency to head the Economic
Research Area of ORR.** His tour in this assign-
ment had seen the substantive growth of the activ-
ity from a concentration on the Sino-Soviet Bloc
economies to a mission of tacit responsibility
for research and reporting [] of
both the Communist world and the Free World and
ranging in complexity and economic sophistication

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[] accession at the start of 1968, although it was a formal change in leadership, represented actually a continuity in the Office's functions and modus operandi because of his long association with the activity. Like [] he was an aggressive promoter of the Office's products and the policy support orientation of the Office's substantive output continued. The changes that took place under his leadership resulted primarily from external events - the minor and major crisis situations on the world scene and developments in the US international strategic and economic posture -- and from his recognition of the opportunities that such situations offered. The most striking of these developments coincided -- by chance -- with his accession at the start of 1968. This was the international monetary crisis highlighted by the devaluation of sterling at the end of 1967, which brought OER for the first time to detailed analysis and reporting on international monetary problems.

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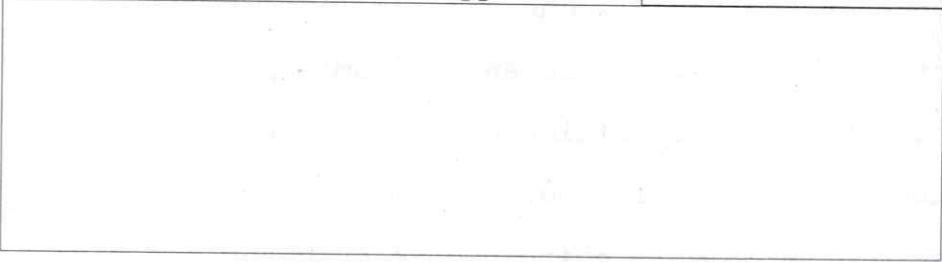
B. International Monetary Problems

During the 17 years of ORR's existence, significant developments in the arcane field of international finance, although of professional

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interest to a number of ORR's economists, were largely academic in terms of the Office's assigned responsibilities. The reconstruction of the West European economies and the intricate operations of the international monetary system which helped to make it possible were not directly related to ORR's mission of analyzing the economic mysteries of the countries of the Sino-Soviet Bloc. The latter, having stood apart from the Marshall Plan's reconstruction program and from the international monetary system which supported it



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a knowledge of the intricacies of international finance was only peripherally useful for this purpose. Except for the occasional in-house memorandum prepared to keep the DCI or the DDI informed of events on the international monetary scene, ORR stuck to its knitting and officially ignored what were, in retrospect, the most significant international economic developments of the post-war period.

* See Volume II.

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The unprecedented increase in the volume of world trade and the rapid economic growth of the major Free World industrial countries occurred in and were fostered by an environment of international monetary stability based on a structure of fixed exchange rates established late in World War II at the Bretton Woods Conference. The International Monetary Fund, also created at Bretton Woods, provided the mechanism for maintenance of this stability. After the period of post-war reconstruction -- i.e., by the mid-1950's -- this system was working efficiently in terms of encouraging world trade and economic growth. Between 1958 and 1966, the volume of world trade rose by more than 90 percent. Japan and the major countries of the West -- with the exception of the United Kingdom -- experienced rapid economic growth. The role played by the United States in financing the smooth operation of the international monetary system was enormous. From 1958 through 1967 the flow of dollars and gold from the United States contributed 70 percent of the total increase in official world reserves. 5/

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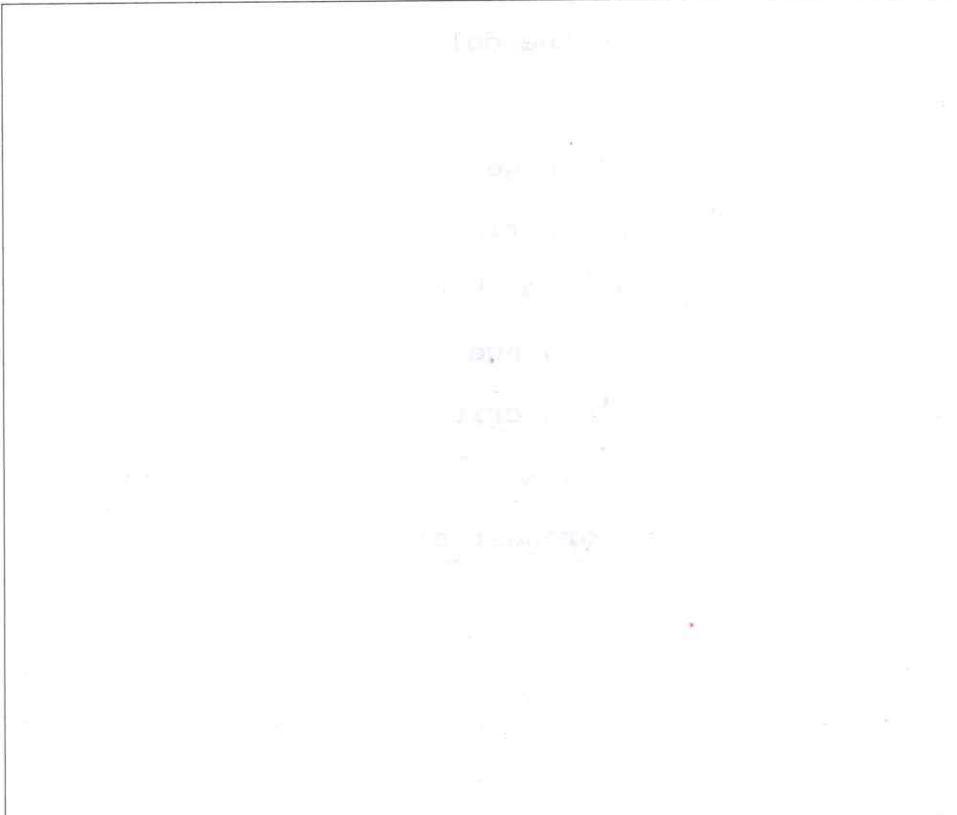
Weaknesses in the system were becoming apparent in 1967 at just about the time OER replaced ORR's Economic Research Area and was broadening its activities to become a significant arm of US economic intelligence support on a worldwide scale. The first major crack in the international monetary system occurred with the devaluation of the British pound in November 1967. As indicated above, the United Kingdom had chronically been the major exception to the pattern of rapid economic growth and balance-of-payment surpluses in Western Europe. On several occasions it had faced balance-of-payments crises because of persistent unfavorable trade balances and a long-term drain on its capital resources. Previous crises, notably that of 1964, had been contained by the cooperative action of the central banks of the nine-country "gold pool," set up in 1961. These powers had provided the gold resources to meet the periodic speculative attacks on sterling. The crisis of 1967 stemmed, as had the others, from the poor performance of the British economy and from sterling's traditional role as a reserve currency. Officially alleged to have aggravated the situation in 1967, however, was the

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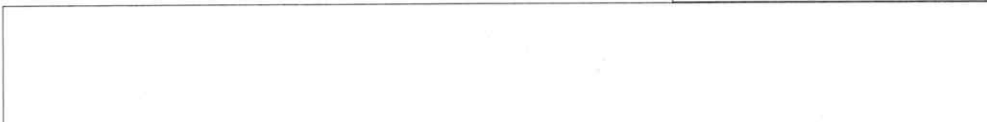
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Arab-Israeli war -- which resulted in closure of the Suez Canal and the flow of Arab funds out of sterling into other currencies. [REDACTED]

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[REDACTED] An unusually large trade deficit in October 1967 appeared to have triggered the flight from sterling [REDACTED]



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[REDACTED] When the devaluation of the pound occurred on 18 November 1967, OER issued several reports outlining the background

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and the implications. 7/ One of these, prepared in collaboration with OCI, dealt particularly with the probability of further pressure not only on sterling but also on the dollar. The DCI, Richard Helms, and the DDI, [] were understandably edgy about the Agency's getting involved in matters that seemed at the time remote from its official concerns and also about the competence of their economic intelligence unit to make useful contributions in such a critical field. At Helms' direction, [] and OER's [] carried the paper with its forecast of dollar problems to

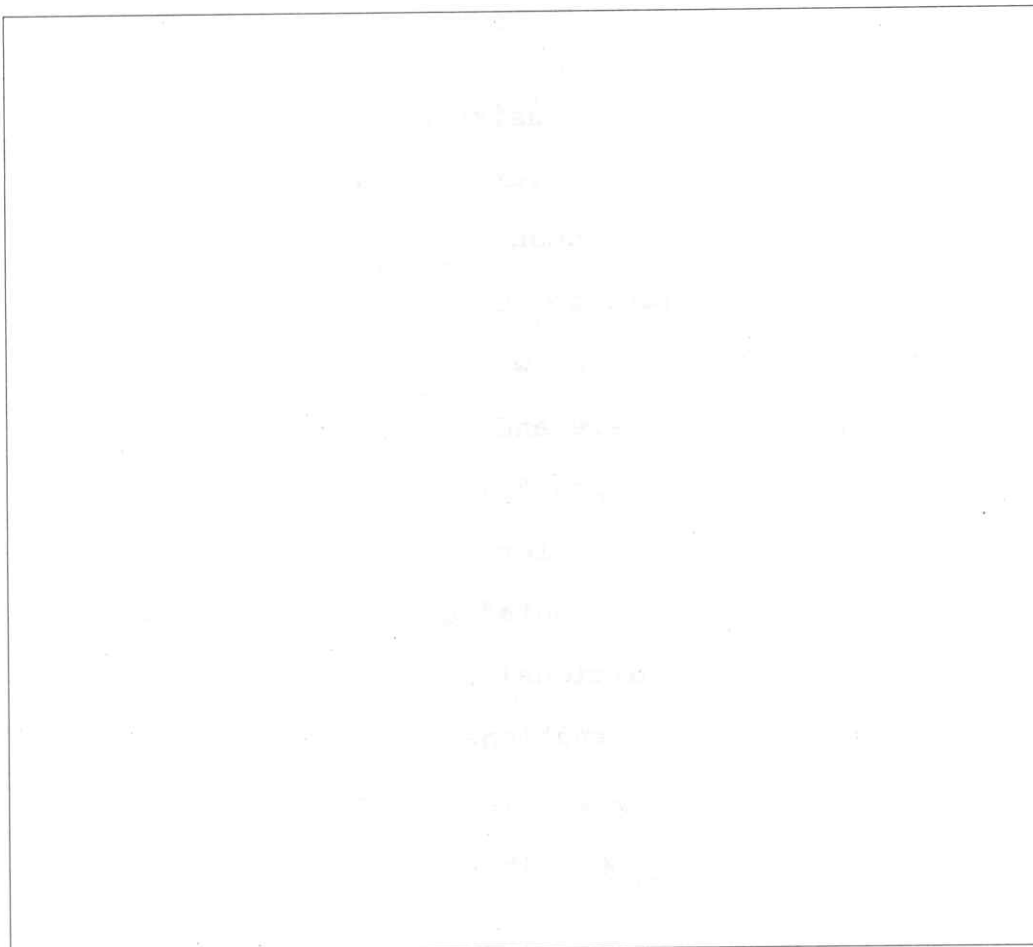
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The activities of the De Gaulle government in
the so-called "Gold Rush" of 1967-68 were of con-
siderable interest to OER's customers

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[redacted] The French government had consistently opposed the dominant role of the dollar in international finance and had for some time been converting its official reserves from dollars to gold and in other ways attempted to promote the world role of gold -- against that of dollars and sterling. It had withdrawn from the "gold pool" in June 1967 and had obstructed negotiations for the implementation of the "special drawing rights" agreement which was an effort to create additional reserve assets for member countries of the International Monetary Fund. In the weeks immediately following the sterling devaluation of 18 November 1967 [redacted]

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[redacted] Le Monde revealed publicly items of financial information of great sensitivity. [redacted]

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[redacted]

OER's reporting with the judgment that they "were important factors contributing to the massive speculation against the dollar and the pound during the recent gold crisis". 10/

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Throughout the first quarter of 1968, the Office continued to issue reports on international monetary problems. 11/ Its monitoring of the deepening crisis put it in a good position to analyze the next major turning point in March -- the establishment of the "two-tier" market system.

The British devaluation and the supportive activities of the major financial powers -- except France -- had slowed the speculation activity for several months, but in the spring of 1968 heavy gold buying pressure again reached panic proportions. On 17 March the seven leading "gold pool" members decided to withdraw from private gold transactions allowing the open market price to be determined competitively while maintaining the \$35 an ounce price for inter-government transactions. [REDACTED]

[REDACTED]

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[REDACTED] The favorable reception given to this report and the continued demands for support on the subject, particularly from the

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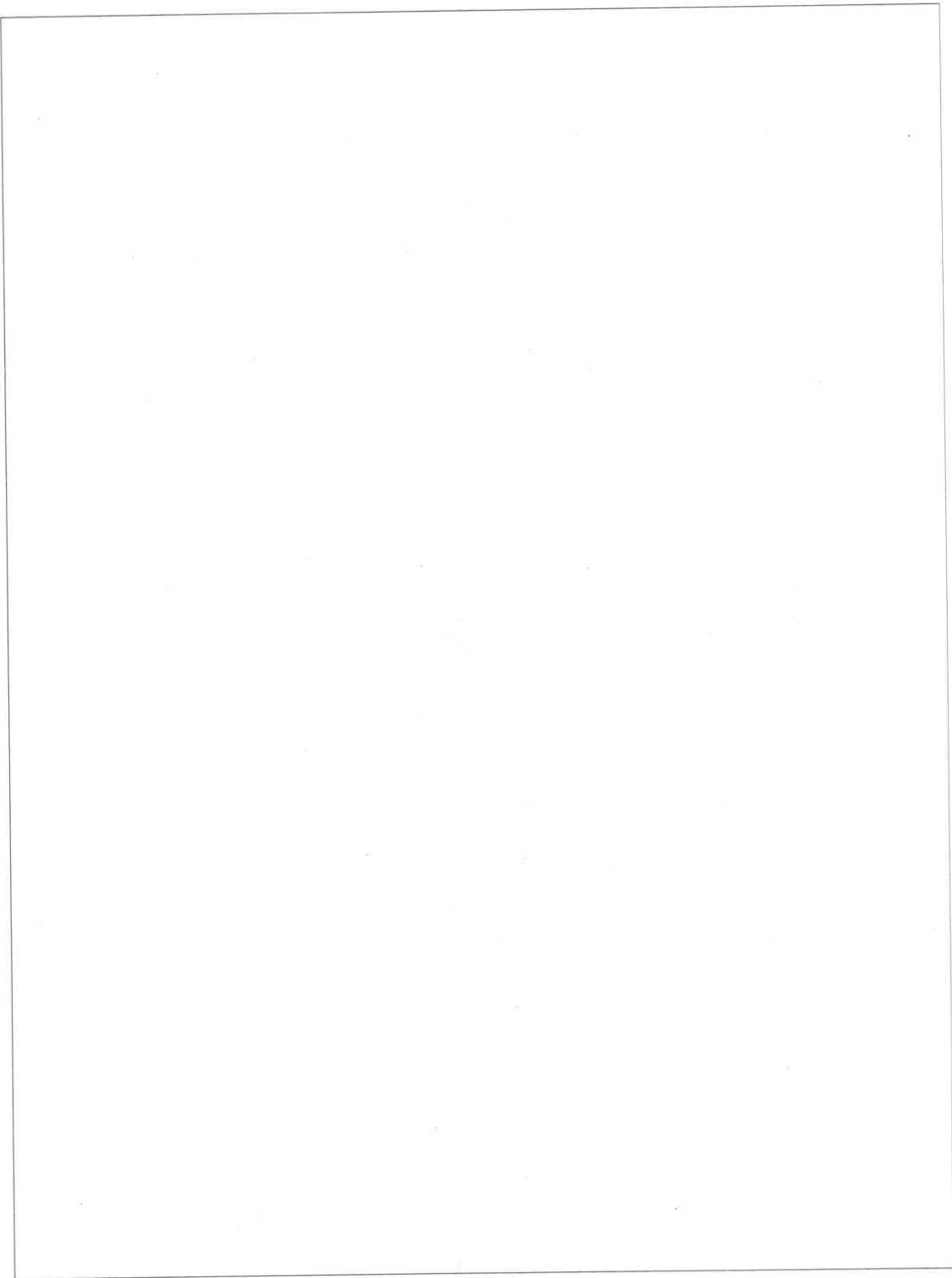
Treasury Department, led in May 1967 to a decision by [] to launch a new economic intelligence series, which included both occasional papers on specialized topics and -- begining in July 1967 -- a monthly publication on the World Gold Market. These issuances, entitled the International Financial Series, started with an analysis of the South African position in the gold market. South African had, in fact, temporarily dropped out of the market in order to push the Free World price up under the competitive situation created by the new "two-tier" system. The OER report detailed the development of what it called "the battle for domination of the new free gold market" 13/ by various private groups, pointing out that South Africa could maintain a gold embargo "for many months...at least through the remainder of 1968. 14/ The second issue in the series extended this estimate to "it probably could continue to withhold gold well into 1969 if necessary by borrowing abroad with relatively minor interest costs."*15/

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* South Africa, whose gold sales had been running at about \$1 billion a year prior to the establishment of the two-tier system, withheld about three-quarters of its gold output from the market in the year following. 16/

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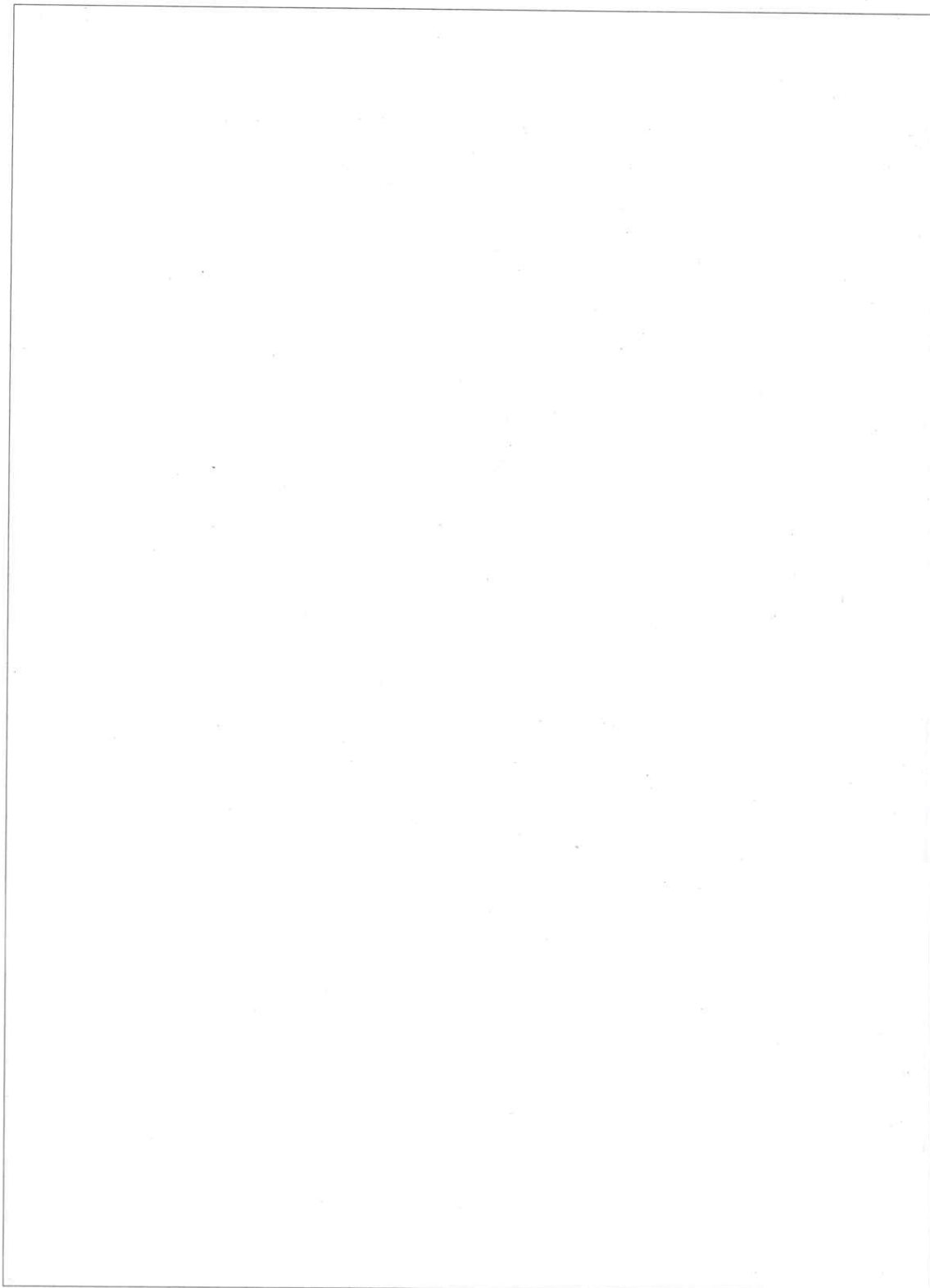
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[REDACTED]

With the change in administration in January 1969, there was no diminution of interest in OER's products with respect to international monetary problems. The Office was requested to prepare a background paper for an NSC meeting in March 1969 analyzing the attitudes of European governments, businesses, and banking interests toward a change in the price of gold. [REDACTED]

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The highly specialized reports [REDACTED]

[REDACTED]

[REDACTED]

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were

supplemented by more basic "primer" type of reports,

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A more de-

tailed paper of this type was issued on April 1969,

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~~SECRET~~The Problem of International Financial Stability.*

This paper presented a summary of the rise and functioning of the international monetary system since its establishment in 1944 and the strains which it had undergone during 1967-68. More importantly, it analyzed the existing strengths and weaknesses of the system and discussed some of the proposals for reform. In a prescient forecast of coming difficulties, it concluded that such proposals would:

Conflict with differing national policies and interests. Thus basic reform raises unavoidable and fundamental political problems.

Perhaps the most difficult problem concerns the power of countries with consistent surpluses in their international payments. The international financial system would work much better if surplus countries shared in the burden of adjustment than if they left nearly the entire adjustment to deficit countries, as has been the case for years. But there is no way to force the surplus countries to make adjustments nor reason to believe that they would readily

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agree to some new international financial rules that would much curtail their freedom of action. 20/

C. The Pueblo Incident

As do all years, 1968 had its share of flaps which engaged the attention of the intelligence community, and demands on OER for economic support characterized most of these situations. The first of these in 1968 was the Pueblo incident, which required the Office to take a new look at North Korea.

On 23 January 1968 the Navy's intelligence ship USS Pueblo was seized off the coast of North Korea by North Korean patrol boats and taken in to Wonsan, where its crew was detained for nearly a year. This action was interpreted in the community as a manifestation of a step-up in North Korean aggressiveness -- only a day or two before, a group of North Korean infiltrators had entered the South Korean capital in an apparent attempt to assassinate President Pak.

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The formal

manpower assignment to North Korea was raised for
FY 1969 to [] positions and over the ensuing
two years, economic intelligence output on North
Korea increased substantially.

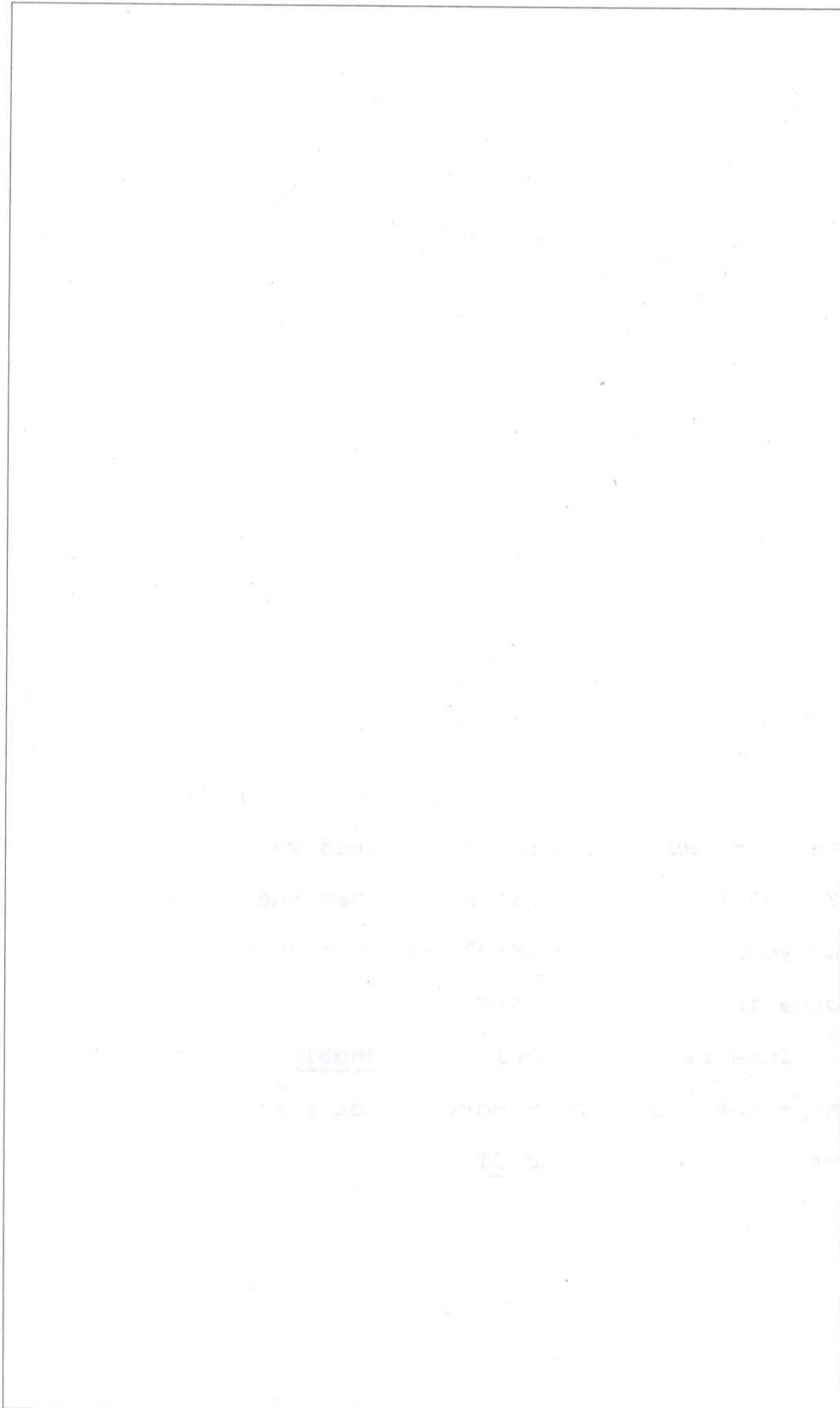
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Immediately following the Pueblo incident, []
in-process reports on North Korea's foreign trade
were hastily released 21 []

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North Korea made the headlines again in April 1969 with the shooting down of a US Navy EC-121 reconnaissance plane over the Sea of Japan. [REDACTED]

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[REDACTED] In addition, [REDACTED] advised the DDI on 18 April that North Korea's policy of belligerence was being maintained at considerable cost in economic terms and that it was "semi-isolated both within the Free and Communist Worlds." North Korea's failure to receive economic credits or grants since 1961 had had an adverse effect on imports needed for development, and there had been a significant slowdown in economic growth. While the North Korean diversion of resources to military uses had caused a postponement of economic goals, South Korea, in contrast, had "blossomed forth, benefiting most recently from heavy Japanese private investment." He concluded that:

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It would be unfortunate if the US took any action against North Korea which prompted the resumption of the subsidized flow of industrial machinery and equipment that the USSR (and to a lesser extent, Communist China) furnished during the later 1950s to the North. Things on the Korean peninsula have been going pretty well. Hopefully, we can have some effect on our allies to continue to deny credits to North Korea. 23/

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By 1972 the general world atmosphere of detente was being reflected in cautious discussions between the two sides with respect to the reuniting of families and the possibility of other non-political accommodations and even trade had heightened considerably.

The potential of trade between the two was analyzed by OER in mid-1972 in a report which summarized Korean economic developments for the post-World War II period. It noted that the complementary nature of the economies of North and South Korea at the time of partition (1945) had been gradually altered as each had made compensations for its natural economic deficiencies. North Korea, formerly the heavy industrial area, had attempted to develop agriculture and consumer industries at least to satisfy minimum domestic demands and had reestablished trade ties within the Communist World. South Korea, on the other hand, had strengthened its industrial base and developed export markets in the West. Thus what might have been a natural and extensive trading relationship

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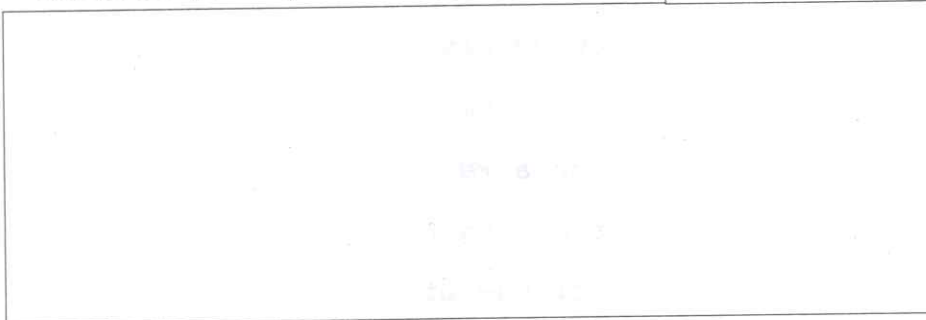
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in the immediate post-war period has become less likely over the years. The report concluded that

... continued emphasis on policies to overcome the original deficiencies in the respective economies suggests that the two Koreas will need each other even less in 1976 than they do today - from the economic point of view. The separate international orientations developed over the past quarter of a century seem likely to continue; they underscore the position of North Korea as a largely self-sufficient "command economy" and the position of South Korea as a "market economy" with strong international ties. 24/

D. Biafra

The Office's ability to provide support on African policy matters was tested



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The Office's initial assessment of Biafra's economic viability at the outbreak of the Nigerian civil war in mid-1967 had noted that the original territory of the break-away state was basically self-sufficient in food. 26/ It will be recalled, however, that the Nigerian civil war had in its closing months resulted in a compressing of the several million Ibo tribesmen, who were attempting

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to establish the separate nation, Biafra, onto a shrinking territorial base in southeastern Nigeria. The federal government's blockade of their territory, a swollen population, and an inadequate food supply were causing widespread starvation and death, particularly among the aged and the very young. Worldwide sympathy, stimulated by reports from foreign relief workers and other observers, was placing the US Government under considerable pressure to provide emergency food relief. The major difficulty -- aside from a distressing rivalry among the several relief agencies involved -- was that nobody has a clear picture of the magnitude of the problem.

In order to provide a realistic basis for a relief program, OER's Africa Branch, augmented by the temporary return of one of its experienced analysts [REDACTED]

[REDACTED] attempted to winnow from the many horror stories of starvation and from all other available information some measure of Biafran food requirements. The problem was not solely a matter for economic research and analysis. It required as well the application of skills in demography, agronomy, nutrition, and anthropology and the resulting report included:

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(1) An attempt, through analysis of previous censuses, estimates of refugees movements, and reports of starvation - related deaths, to reduce the population estimate range of 4 million to 10 million in Biafran-controlled territory to a workable figure. The analysis arrived at a population figure of 6.5 million to 6.9 million which was rounded up to 7 million to minimize the chances of grossly underestimated food requirements.

(2) An analysis of the agricultural setting in terms of principal food crops, agricultural practices, production patterns, and the crop cycle. The analysis concluded that the starvation and malnutrition death rate of the previous several months were caused less by overall caloric deficiencies than by displacement of people, food distribution problems, and the shortage of protein. A crisis of considerably greater magnitude, however, could be expected in the coming year as these causative factors were aggravated.

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(3) An analysis of the types of relief food needed. This required not only an estimate of calorie and protein requirements but a knowledge of the dietary habits of the population.

On the basis of admittedly rough calculations and estimates, the Office response to State's request for assessments of the likely requirements placed the need at "100 tons of high-quality food per day." 27/

As often happens with the Office's policy support products, it is not possible to assess the degree to which this study influenced the policy decisions which followed. US food relief to Biafra was effected, and the existence of an objective working figure -- admittedly based on very sketchy evidence -- at least provided better guidance than the wildly varying pronouncements coming from the competing relief agencies, the federal government of Nigeria, and the Biafran regime.

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(b)(3)E. Automatic Data Processing

The potential of automatic data processing machinery in economic research had received early attention by ORR, although the first rudimentary application of these devices had been in the field of research management in the late 1950's and early 1960's. During that period, characterized by massive research projects of months and sometimes years duration and by annual research program planning, the services of the IMB key-punch, card-sort, and print-out capability were engaged to keep tabs on project progress and analyst time allocation. The data inputs came from weekly time sheets prepared -- with much reluctance -- by each analyst and branch. Although most analysts regarded the time sheet as a harassing "watchdog" and a bureaucratic nuisance, its purpose was to monitor not the analyst but the

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project and support functions of the Office. It was abandoned in 1962 at about the time of ORR's first major reorganization and thus roughly coincided with the "new look" in research management which resulted from the burgeoning of policy support requests, short problem-oriented papers, and the gradual abandonment of exhaustive research projects requiring many months for completion.

At about the same time, the Economic Research Area was beginning to exploit the capabilities of computers and allied machines for substantive data storage and retrieval as well as data manipulation and compilations. These usages -- as of mid-1974 -- included:

a. Computer calculation of indexes of Soviet industrial production. The capabilities for rapid calculation made it possible to revise the index several times a year, which would have been too time-consuming by traditional methods. The index was, of course, an important component in the much demanded estimates of Soviet GNP.

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e. The many demands on the Office for estimates and projections in the field of military expenditures, military manpower allocations, and the military hardware components of the Soviet production index were greatly facilitated by computer storage and manipulation.*

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[redacted]

In October 1967, in order to assure that the potentialities of automatic data processing were being fully exploited in economic research, [redacted] set up an automatic data processing committee, consisting of his executive assistant, [redacted] and [redacted] senior analysts with extensive backgrounds in econometrics -- [redacted]

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[redacted] This committee assisted [redacted] in developing training courses for selected analysts -- the first of these was a six-month workshop set up in 1968 -- and in working with the Office of Computer Services to develop appropriate applications of ADP to specific problems in economic research.

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The first of these was an analysis of Indonesia's foreign debt carried out in December 1967. Indonesia at that time was returning to respectability among the Free World nations after the overthrow of Sukarno and the putdown of the Indonesian Communist Party. Its economy was, however, in atrocious shape after years of mismanagement. 30/ One of the many problems for economic intelligence was to attempt an analysis of Indonesia's muddle of foreign indebtedness and continuing foreign assistance needs. [redacted]

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[redacted] OER developed an ADP analysis

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which was one of the first instances of computer application to the study of a Free World and Communist countries [REDACTED]

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[REDACTED] The mix of repayments of fixed debts and the servicing of private loans under government guarantees were obviously far beyond Indonesia's foreign exchange earnings prospects, raising the probability that any new aid extension by the United States, for example, would be used primarily for (or would release funds for) loan repayments to other creditors, including the Communists. The attempt to put financial obligations was, from a statistical point of view alone, a staggering task, but it proved well suited to computer application. [REDACTED]

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[] Although confirming the experts' worst fears about Indonesia's basic insolvency, the results provided a firm and rational basis for the US Government's financial planners' work with the International Monetary Fund and other donor countries toward setting Indonesia on a reasonable financial course. 31/ The technique was then adapted at the Department's request for use with four other major debtor nations.* In addition a global model was developed for the analysis of all debt, repayment, and continued aid needs of all less developed nations. 32/

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Another application developed early in 1968 was the processing of data from captured documents on Viet Cong and North Vietnamese manpower in order to estimate and project force levels and recruitment rates.**

These ADP applications were bellwethers of a growing demand for expanded use of computer applications in economic intelligence production and for the more sophisticated quantitative methods that these devices made possible. By the end of 1968, some [] ADP projects were in the works and a number of analysts were being trained in the application of these methods. Early in 1969, a Systems Development Staff was

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* Turkey, India, Pakistan, and Brazil.
** See Chapter IV.

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established with [] as its Chief. (b)(3)
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The staff was designed to centralize the burgeoning activity and formalize the training of analysts and assist in the management and improvement of existing programs and the development of new ones as well as to coordinate the Office's activities with the Office of Computer Services (OCS) and related components. 33/

The Systems Development Staff operations included the following areas: model design, data base construction, computer systems procurement, and administration and training. []

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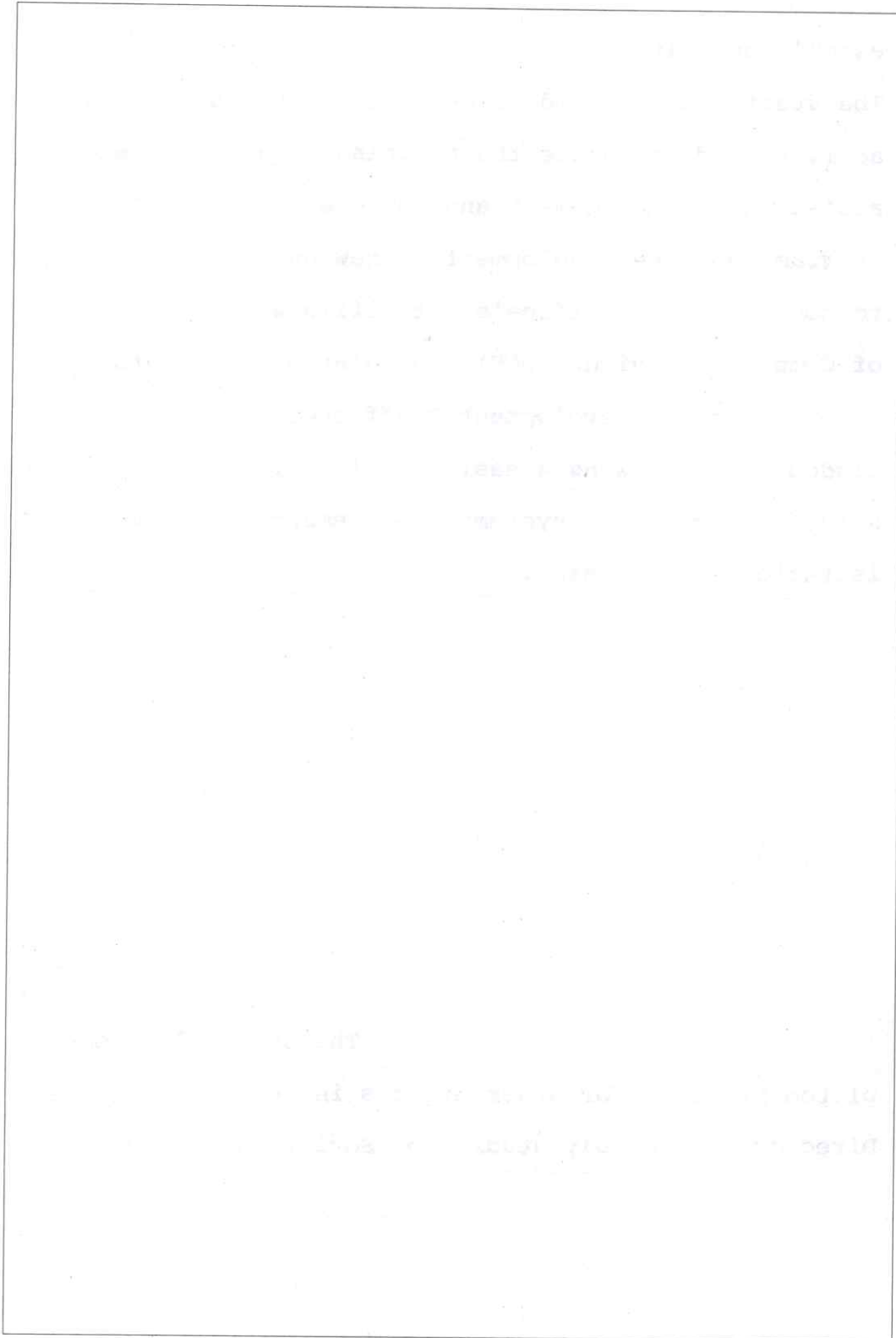
[] The staff also completed projects for other offices in the Intelligence Directorate, notably studies of Soviet intentions

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As for training, the staff has given OER analysts courses in econometric methods and in various programming languages. In all cases, the training program has complemented courses offered by OJCS and by local universities. For example, students who learned econometric theory in graduate school have been taught how to apply the theory by using Agency computer facilities.

With the establishment of the System Development Staff, the Office became capable of moving to new levels of sophistication in economic research and analysis. By the early 1970s, virtually all major areas of the Office's substantive responsibility was feeling the impact of computer technology and techniques -- particularly, analysis of Soviet and other Communist economies, Vietnam problems, Free World development problems and more recently, international monetary affairs. Some examples of these techniques and their applications in the major substantive fields indicated are discussed in the following chapters.

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Chapter III

THE TRADITIONAL TARGETS

Q. "Professor, why do you give the same exam every year?"

A. "In economics we never change the questions—only the answers."

Traditional

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Notwithstanding the growing burden of Vietnam and the new worldwide responsibilities of the Office, both of which were taking an increasing toll of personnel resources, it was nevertheless incumbent on the Office to continue its major traditional tasks of analyzing the Communist economies -- as of the end of 1971, these duties

	Policy interest in the Office

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product on these countries has remained high -- not only for the overriding reason that the strength and vigor of their economies are determinants of their military posture and of their potential threat to US security interests, but also because of the possibilities of closer economic relations stemming from an improving atmosphere of detente and a felt need to keep US trading relations in constant repair.

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~~SECRET~~A. The USSR

In the last half of 1967 there were in the Soviet Union no pressing economic developments or issues demanding serious policy attention. The new Kremlin leadership team of Brezhnev and Kosygin was proving to be less provocative and adventure-some than Khrushchev had been at a comparable stage, while the Soviet economy was operating relatively smoothly, and its performance during 1966-67 had, in fact, considerably improved since the revelations of its stumbling course, publicized by ORR in 1964.* A DDI/ONE joint memorandum sent to the DCI and the President early in 1968 contained in its economic section the following judgments prepared by OER:

The collective leadership has reason to be pleased with the performance of the economy during the first two years of the current Five Year Plan. Economic growth, which had slowed under Khrushchev, accelerated in 1966-67. Agricultural production was at a record level in 1966 and remained high in 1967. Above-average weather -- especially in 1966 -- played a vital role in this increase, but new monetary incentives and more fertilizer also had a beneficial effect. The growth of industrial output increased significantly, in part as a result of greater raw material supplies from agriculture. Most of the production goals of the Five Year Plan are being fulfilled. With large emergency wheat

* See Volume II.

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imports no longer needed, gold reserves increased and the hard currency deficit dropped. Implementation of the major economic reform launched in late 1965 has proceeded relatively smoothly, and the reforms appear to be yielding some small improvements in efficiency. 34/

OER's contribution did, however, point out that serious economic problems had to be faced by the Soviet leaders. Having favored defense and consumption at the expense of industrial and agricultural investment during the two years under discussion, they were weakening the long-run prospects for economic growth. Although OER was not prepared to forecast a down-turn in the rate of growth for 1968, the investment decisions of the previous two years were apparently to continue, thus risking a future slowdown in the growth of industrial output as well as in agriculture. 35/

The analysis of the Soviet economy in the 1960's and early 1970's benefited from the greater availability of data and from improved and more sophisticated analytical techniques. The improvements in data availability did not, however, simplify the tasks. Official Soviet statistics, although much improved over the Stalinist period, continued to be obscure in meaning and widely suspect. 36/ The periodic release of statistical

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handbooks which the Soviets began in 1956 provided data of varying reliability and completeness

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1. Input-Output Analysis**

As recounted in Volume I, ORR made a considerable effort in the 1950's to construct input-output

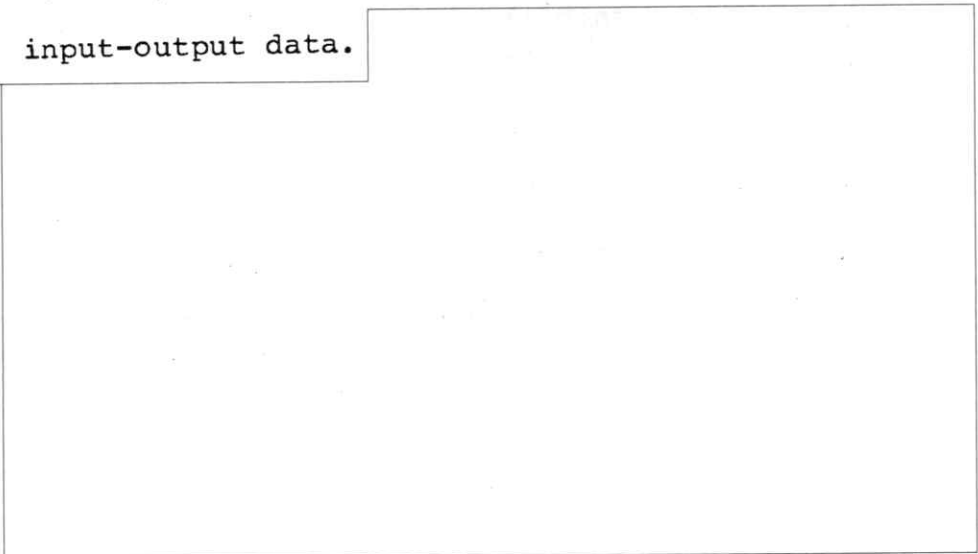
* The Soviet Union does not publish estimates of GNP. The published data are based on a Marxian concept of "material product" which differs substantially from the Western definition of GNP principally through the exclusion of services.

** Input-output analysis is a technique of breaking down each economic sector's inputs by identifying its receipts [footnote continued on p. 54]

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tables for the Soviet economy. The data available at that time were so meager and unreliable that the effort was abandoned.* In the early 1960's, however, the Soviets began to release their own input-output data.



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A number of problems have been encountered in the use of this material. These include:

(1) the Soviet data still fail to disclose the key items of interest, particularly for military procurement. Thus there has been considerable lack of agreement in the community as to where military spending appears in the statistics -- or if it appears at all.

(2) the degree of disaggregation has not been sufficient to reflect any but gross

(purchases) from all other sectors and its output by identifying its deliveries (sales) to all other sectors. It makes possible the tracing of the effects of changes in one sector, e.g., shortages, in all other sectors of the economy. Thus it has an obvious application as a tool of intelligence analysis.

* See Volume I.

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changes and the sector classifications have not been compatible with or completely understandable in terms of US usage.

(3) Although it does not appear that the Soviet data have been doctored, it is apparent that they easily could be and therefore the possibilities of deception must be continually suspected and allowed for. 38/



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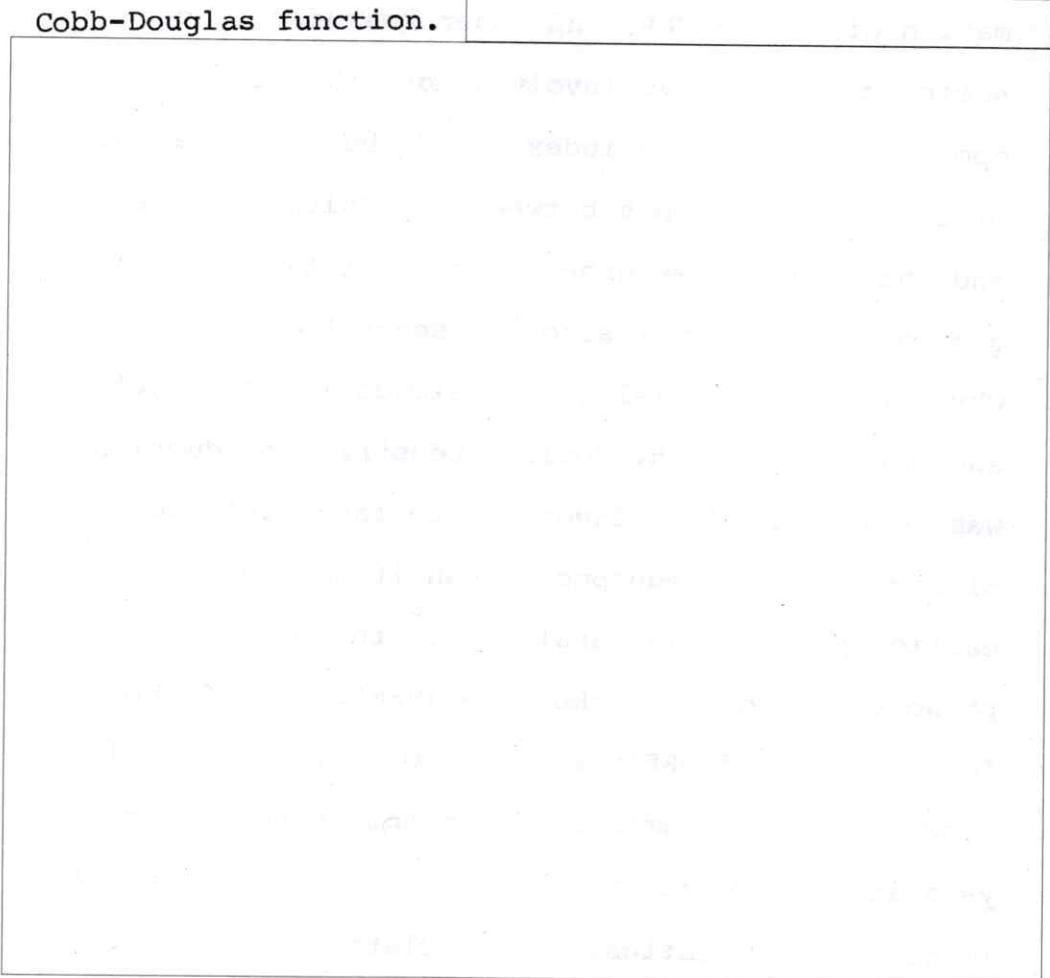
2. Depth Analysis of Soviet Growth

The work on Soviet national accounts, the estimation of Soviet GNP, and other measures of economic activity, have involved more than the development of production indexes and the presentation of annual comparisons between the United States and the USSR in response to policy interest in a growth race. It was also necessary to analyze why Soviet industrial growth slowed in the 1960's and particularly why Soviet industrial production was responding less favorably to large infusions of new plant and equipment than it had in the earlier period. The analysis of this latter phenomenon became in the late 1960's one of the focal points of OER's analysis of Soviet economic growth. The economic tool for this type of analysis is the production function -- a formula which expresses mathematically the relationship between

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output and the factors which are presumed to determine it: capital inputs, labor inputs, plus a residual, which includes the impact of new technology, management improvements, and anything else that cannot be attributed to measurable changes in the services of labor and capital. The classic -- but not the only -- production function used in this kind of analysis for many years with respect to the US economy and most others has been the Cobb-Douglas function.



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3. Studies of Soviet Technological
and Managerial Efficiency

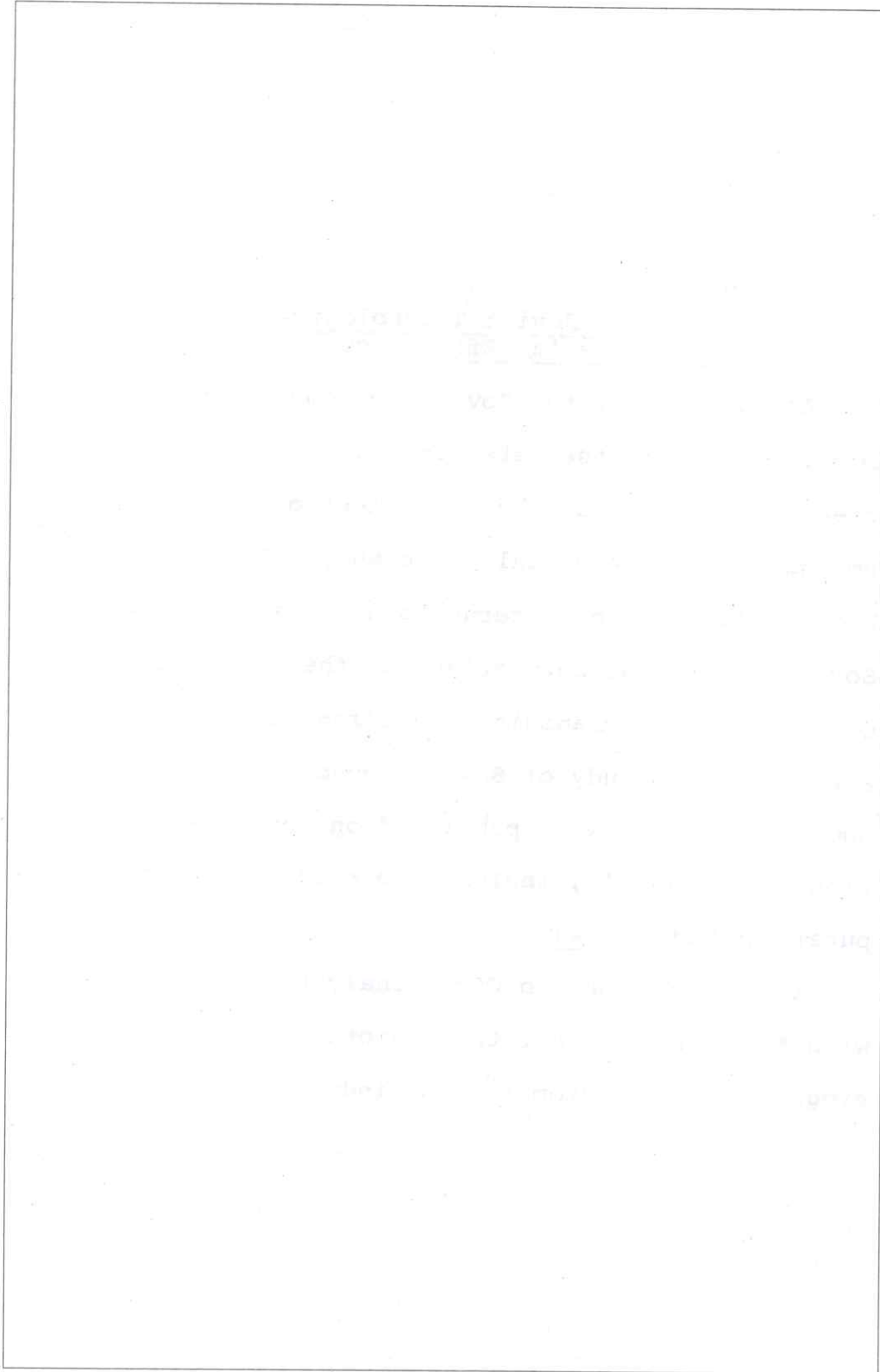
As analysis of the Soviet economy became more sophisticated in the late 1960's, a matter of increasing concern was the assessment of Soviet technological and managerial efficiency. The Office had, in fact, been concerned since the 1950's with Soviet efforts at automation and the development of automation mechanisms, including computers, as a part of its study of Soviet economic growth. A number of papers were published on Soviet automation in the 1950's, including one on Soviet computer production. 41/

It was apparent to ORR's analysts concerned with this inquiry that the Soviets were making slow progress in the automation of industry.

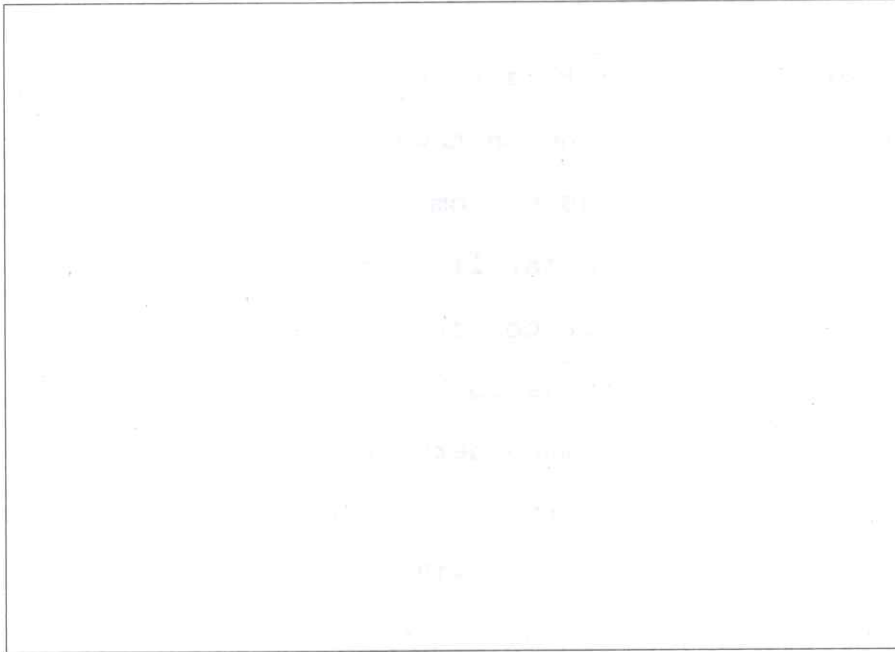
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One compelling reason for ORR's interest in Soviet developments in automation was the need to counter a tendency on the part of some observers who had concluded from the Soviets' fervent and propagandistic pursuit of automation theory that the USSR was threatening the US lead in this field. ORR's analysis in 1960 and 1961 was an effort to weed out from the propaganda some bases for objective judgments of the Soviet position. It quite readily reached the conclusion that the resource situation in the USSR would permit only selective applications of automation. The Office thus retained a skepticism with respect to the impact that automation could be expected to have in the near term on economic growth and found it

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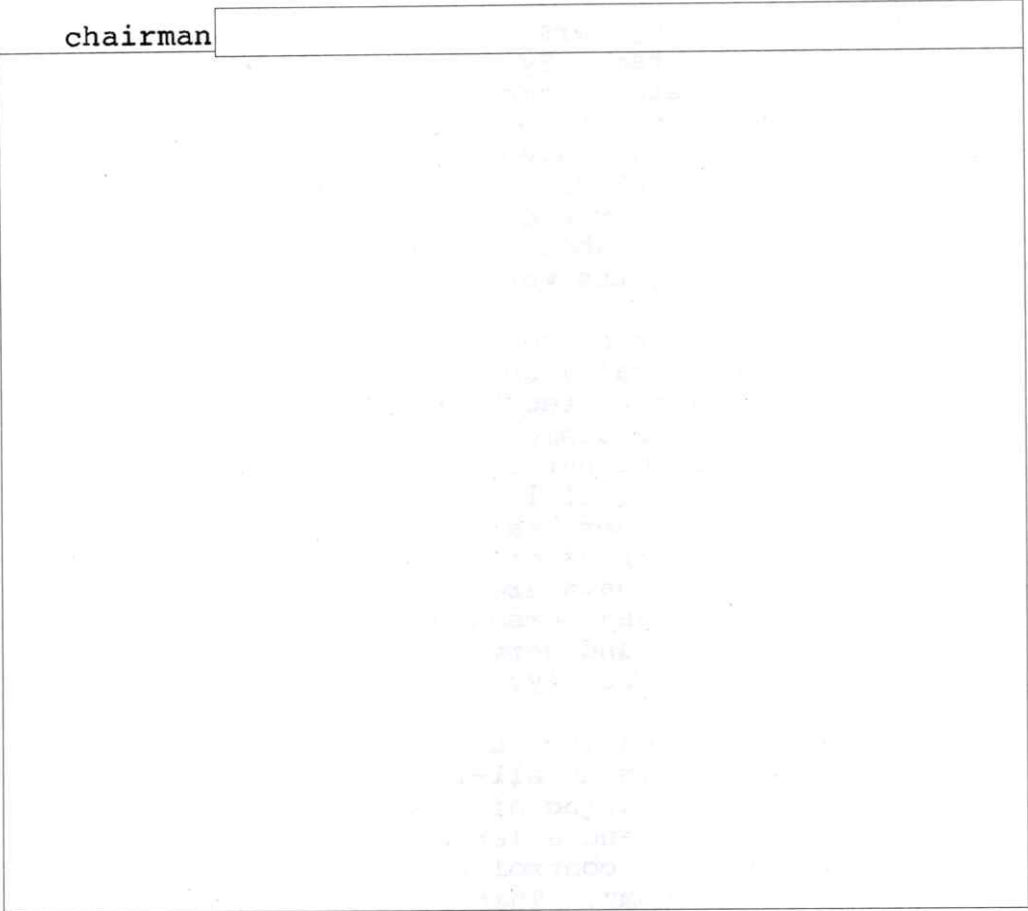
necessary to express this skepticism with some frequency in commenting on news releases on Soviet automation has well as on some of the products of other elements in the intelligence community. 43/

Although the major concern in the early 1960's was with Soviet progress in applying cybernetics to the automation of machinery and the production process generally, there was also a growing interest being manifested by the mid-1960's in its application to management -- both at the enterprise level and in national economic planning. It was generally recognized that growth in the Soviet economy would come to depend more and more on managerial efficiency since the Soviets were already devoting a very high percentage of gross national product to investment. Accordingly an effort was made to put more analytical resources to work investigating Soviet managerial developments [REDACTED]

[REDACTED] ORR's interest in cybernetics as a management tool was matched by OSI's concern with its application to Soviet science and technology. In 1966 an OSI/ORR Working Group on Cybernetics was set up with ORR providing the first

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ORR's study of the Soviets' application of cybernetics in management resulted in a number of reports including a detailed summation of the subject, published in 1967 as the final report in its unclassified dissemination series. This report concluded that:

The computer revolution now sweeping through most of the industrial nations has bypassed the Soviet civilian economy. The USSR still creaks along with a 40-year-old system of processing economic data. Perhaps as many as three million people are engaged in the paperwork system in which hand operations predominate; fewer than

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500 (outdated) computers are in use in the economic data system. By contrast, in the United States, large segments of the economic data systems have been automated with the aid of more than 15,000 computers. Heretofore, the USSR has concentrated its computers on military and scientific work and has only talked about gains to be had from computerizing the workaday economy.

The development of computers in the USSR is technologically about five years behind that of the United States. Development of auxiliary equipment -- such as storage and input-output devices -- to make the computers more efficient for economic uses lags even further behind. Computer languages and libraries of computer programs for economic data are almost nonexistent, and trained personnel for installing operating and servicing computers are still in short supply.

The ultimate goal, or dream, of many Soviet economists is an all-inclusive cybernetic system, consisting of a complicated mathematical model and a large network of computers that will control every important aspect of the economy. This system would receive data from all levels of the economy, synthesize it, and devise a number of alternative plans. The top leadership would merely select one plan, and the cybernetic system would then take over. It would disseminate the parts of this plan to individual enterprises, monitor progress of the plan, and order corrections as required to keep the plan in balance. Although the concept is simple, the problems and costs of acquiring this system are tremendous; especially the difficulties of producing the computers and auxiliary equipment and training thousands of technical personnel. In addition, as the USSR recognizes, some of the mathematical tools necessary to construct the model have not been developed in theory or in practice. The size and complexity of these obstacles helped to convince the Soviet leaders they

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should be content for the present with only the computerized information system and not push for a full-blown cybernetic system. But another reason is a substantial school of thought favoring decentralization of economic control by use of market processes and profit incentives. The current economic reform is a token step toward decentralization rather than toward planning with computers. 45/

These judgments with respect to the Soviet computer industry were only a part -- although a significant one -- of the broader judgments being made by OER about Soviet technology in general. OER's research and reporting on the growth of the Soviet economy was increasingly stressing the fact that despite continued inputs of capital and labor at about the same annual percentage rate as in the 1950's, factor productivity in the 1960's was declining sharply. Factor productivity is fundamentally a reflection of the degree of progress in management and production techniques and in the application of new technology. Accordingly, its decline was, in OER's view, an indictment of the Soviet system and evidence of the lack of progress in these dynamic respects. Thus Soviet industrial growth, after two relatively successful years (1966-67) began to decline again in 1968, and this falling off spread to the economy as a

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whole in 1969, suggesting that the point of diminishing returns had been reached. The failure of the USSR to match Western technological development during the 1960's contributed not only to its failure to fulfill the promise of Soviet Premier Khrushchev's boast that the USSR would catch up to the U.S. quantitatively in the economic sphere by 1970 but also had been reflected in its lack of qualitative growth. A comprehensive report by OER published in June 1969 spelled out in detail the large and apparently widening technological gap between the USSR and the developed West. 46/ This report presented a series of brief industry-by-industry summaries showing that in no major branch of industry was the average level of Soviet technology on a par with either the United States or Western Europe. Although the technological gap had apparently narrowed somewhat in the 1950's, it had been widening again in the 1960's. As of the time of the report, it was estimated that productivity (output per unit of capital and labor) was only about one-third that of the United States and a little over three-fifths that of Western Europe. Even these rough estimates do not take account of the great differences in product quality or

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diversity. The report went on to suggest some of the reasons for this gap, including differences in the educational attainment of the respective labor forces and the relative expenditures on research and development. Although the West came off better in these comparisons as well, the Soviet technological lag could not be explained by these differences alone. The report concluded that it was the Soviet centralized system of economic management that was the main culprit. Despite recent tinkering, such as the adoption of market-type concepts -- prices, sales, profits, and return on capital, the system continued to eschew the use of markets and to manipulate the economic variables by traditional means -- Socialist planning and administration. The result was a considerable increase not only in Soviet administrative objectives (and problems) but also in the size of its bureaucracy.

How scientific and technological progress can flower under these conditions is hard to see. Technological change is a highly dynamic process, requiring entrepreneurship and flexibility. There are no entrepreneurs in the USSR except the state, and bureaucracies are notoriously slow-moving and resistant to change. Furthermore, Soviet higher education continues to emphasize narrowly specialized engineering

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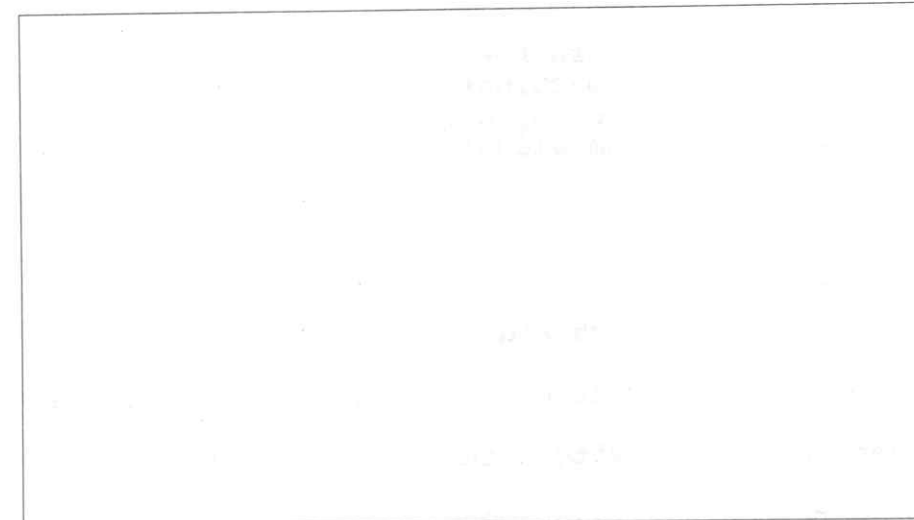
and scientific fields -- training ill-suited to producing graduates with entrepreneurial ability, even should the environment be conducive to exercising it.

In the technological race, countries whose economic institutions permit fast action and rapid adaptation to new things are likely to come off best. In periods of particularly rapid technological change like the present, therefore, the USSR seems likely to be at an increasing disadvantage relative to the West in the average level of technology in use. This may be so even in the field of advanced weapons and space. 47/

The technological gap was, of course, given ample evidence by the eagerness of the USSR and other Communist countries to import Western equipment and technology. Much of the detail of this effort and of the Office's role in aiding the policy-makers to decide the appropriate reaction to Communist requests is presumably covered in the separate history of the economic defense activity. The US and allied denial program aside, the major limitation on Soviet ability to meet its needs by imports was the inability to generate sufficient exports to pay for them. The publicity given to the effort to increase US-USSR trade in the early 1970's tended to obscure this basic problem.

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The following year saw the Soviet's technological import problem further complicated by the need to use scarce exchange resources to finance grain imports. In expressing its doubts that the 1971-75 plan for Soviet industry -- with its reliance on the rapid introduction of new technology -- would be fulfilled, the Office noted that:

The principal obstacles to significantly expanding imports of Western processes and equipment in the immediate future will be the cost of this year's grain purchases, growing indebtedness to Western trade partners, and the problems of generating offsetting exports. 49/

The office concluded that the plan might have to be revamped because of chronic difficulties of this type, concluding that:

Five years is too brief a period to expect a substantial closing of the technological gap which exists between the

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USSR and the Western powers. Nevertheless, the Soviet machinery sector -- on its past record -- may do well simply to keep the gaps from widening. 50/

B. Eastern Europe

1. General

Continuing research and analysis of the economics of the Communist countries of Eastern Europe has been maintained within the Office starting with the preparation and issuance of ORR's first major report, RR Project 6-51, The European Satellite Power Complex, in July 1951.

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During the five-year period covered by this volume, work on Eastern Europe was highlighted by:

(a) A continuing review of economic conditions and growth of the countries of the area.**

(b) Continuing analysis of the gradual diminution of the monolithic character of the European Communist economic system.

(c) Comparative studies of economic growth of the region with Western Europe,

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(d) Studies of trade and trade prospects between the countries of the region and the industrial West.

(e) Response to crisis situations, notably the Czechoslovakian invasion of 1968.

The periodic assessments of the East European economies of this period reached their most elaborate expression in 1970 with the issuance by the Joint Economic Committee of the Congress of its

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** Yugoslavia was added to the Branch's responsibilities in 1967.

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first "benchmark study" on the region. This was a follow-up to the Committee's periodic releases on the Soviet economy

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[REDACTED] The Agency was, however, listed in the foreword as among the institutions cooperating with the committee in the preparation of the study.*

The judgments about the East European economies contained in these articles were characterized by common themes in spite of the diversity of subjects addressed. In sum, the heavy hand of the Soviet economic system lies upon all the countries of Eastern Europe in spite of the different degrees of political independence from the USSR. Thus the patterns of economic performance have been generally similar to that of the Soviet Union -- forced industrial growth and in the longer term, economic retardation. [REDACTED]

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The East European countries were regarded by ORR during the 1950's as part of a Soviet-dominated monolith, and the policies and practices of the Stalinist USSR justified this interpretation. The Council for Mutual Economic Assistance (CEMA) -- Stalin's answer to the Organization for European Economic Cooperative (OEEC) and the Marshall Plan -- did not really function except as a propaganda device until after Stalin's death. Under Khrushchev, however, CEMA became a full-fledged international organization and played an important role in the relations of the USSR with the countries of Eastern Europe.

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In spite of its elaborate structure of permanent commissions to promote technical and economic coordination and

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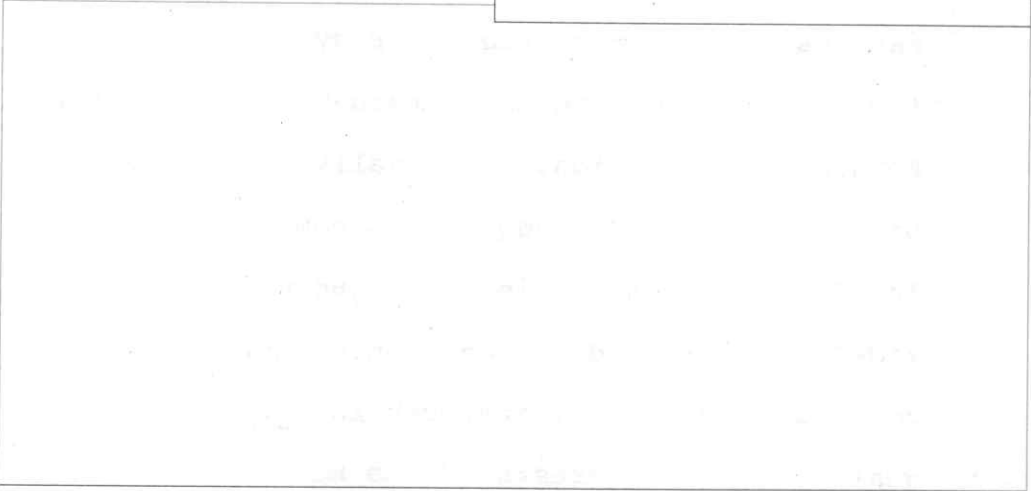
the establishment of such common service organizations as an integrated power system, a joint freight car pool and the International Bank for Economic Cooperation, and finally, the completion of a "show-place" headquarters complex in Moscow in 1967, CEMA had -- in OER's judgment as of mid-1969 -- failed to contribute much to the economic integration of its members. 52/ The divergent economic interests of its members remained unreconciled, and the increase in trade between them was only about half that of the EEC countries since the establishment of the Common Market.

Among the several Communist countries of Eastern Europe, probably the one of greatest interest to US policymakers has been East Germany. Requests for comparisons of economic conditions and economic development in the two wings of divided Germany have, of course, been frequent as it presented an obvious opportunity to compare the impact of the competing economic and political systems in Europe. The subject of trade between the two wings -- interzonal trade -- has also been of interest

In 1968, OER's paper on trade between East and West

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The report pointed to the shifting interests of the two wings in the maintenance of interzonal trade -- East Germany's declining dependence on West Germany's strategic products and its apparent hopes to use declining trade as a weapon in its struggle to gain political recognition as against West Germany's drive for closer political and economic ties with the States of Eastern Europe and the latter's interest in maintaining an increasing interzonal trade to further this drive. 55/

2. The Czech Crisis of 1968

OER's analysis of the divergence of economic interests among the Communist countries of Europe and its awareness of the political implications of this divergence were manifested in a number of

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reports in the 1960's.* That the economic pressures for greater independence were coming to a head was recognized early in 1968. As one of OER's reports of the period put it:

Economic pressure is a major force for political change in Eastern Europe. For 20 years and more the Communist regimes have driven their economies, keeping them under close political control and almost entirely insulated from the world market. Until about 1960 the leaders still hoped to "overtake and surpass" Western Europe, thus "demonstrating the superiority of socialism." By now everyone, including the leaders, realizes that Eastern Europe is not even in the same league with Western Europe. The Eastern European countries produce at higher cost a much inferior range of goods and services, and in these respects they are not gaining on Western Europe but falling behind.

The threat to the Eastern European regimes is twofold. First, the young are intolerant and impatient of waste and

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shortages -- as of oppression and humbug -- and they have leaders among the new elite, in and out of the Party. Second, the Eastern European states cannot capture the national feeling of their people or secure independence in foreign affairs without becoming competitive in world markets. With second-class economies, they are becoming more dependent on the USSR, in spite of the yearning of the elite for more independence. The leaders are on the defensive in the face of these challenges. 56/

The report went on to pin-point Czechoslovakia as the country where economic problems posed the most immediate threat and forecast that these would probably become acute without more realistic policies from the new leadership.* It also stated that "Only with political backing and large-scale economic support from the West can any Eastern European countries carry out basic changes in policies and institutions." 57/

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OER prepared a support project, pointing out that the Czech government, although wanting

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assistance from the West, would have to proceed cautiously, in order to avoid difficulties with the USSR. The political risks of seeking aid from West Germany and the political impossibility of seeking it from the United States -- while supplying arms to North Vietnam -- limited Czechoslovakia's maneuverability in this respect. 58/

The differences between Czechoslovakia and USSR became further exacerbated during the year and culminated in the occupation of Czechoslovakia by Soviet and other Warsaw Pact troops in August 1968. Although an outright military clash was avoided, the sullen Czech populace put up some resistance and there were a number of civilian casualties. OER prepared a number of papers assessing the short-term and long-term implications of these events, both in its regular publication of Intelligence Memoranda* and in response to consumer requests.

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OER estimated that the Soviet burden was on the order of \$400 million -- an increment of about 2 percent to the total costs estimated for Soviet general purpose forces in 1968. 59/ Other costs to the USSR and its Warsaw Pact allies were small, although the reports noted some probable -- but unmeasurable -- loss to the USSR as a result of hostile public reaction in the West. Specifically, they forecast a disruption to Soviet efforts to acquire advanced Western equipment, including third-generation computer technology. 60/ The costs to Czechoslovakia were substantially greater, although not on a scale of the losses suffered by Hungary in the Soviet intervention of 1956. In addition to about \$300 million in damage to roads and transport facilities, there were production losses of several hundred million dollars and hard currency losses of some \$27 million in exports to the Western World, and an unspecified amount from the halting of tourism. 61/

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In more general terms, the Office's intelligence publications dealing with this affair predicted that:

Czechoslovakia is likely to continue to have a substandard European economy, operated under direct state control and dependent on the USSR....

Hopes for a freer, more competitive economy and society aided by Western loans and technology and with close ties to the West must once again go underground. 62/

C. Communist China

Throughout 1968, reporting on Communist China was rather meager as the economy was still feeling the effects of the Cultural Revolution and, as had been characteristic of China for many years, the data on which significant intelligence findings must depend simply did not exist. Early in 1969, the Office issued a "primer" type of report on the Chinese economy as one of a number of basic papers prepared after the 1968 US elections to provide briefing materials for the new administration. This paper noted what seemed to be a slow recovery in industrial production and a generally satisfactory (for China) agricultural year in 1968. 63/ The long-term effects of the Cultural Revolution seemed to be unfavorable because of the radical

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political and economic policies of the top leadership and because of the "shattering" of the Communist Party's experienced managerial apparatus under the impact of the Revolution. 64/

An effort was made in this period to assess the impact of Mao's Cultural Revolution on major industries and facilities. Individual memoranda were issued dealing with the coal industry -- apparently not serious, 65/ the petrochemical complex at Lanchow -- serious disruption and delay, 66/ and the cotton textile industry -- also serious disruptions. 67/

Later reports showed that the picture continued somewhat mixed with quite a good recovery in the iron and steel industry 68/ and a severe setback in the truck industry. 69/

By the fall of 1969, the economy appeared to be moving again, and OER's overview of China's economic situation on the eve of the twentieth anniversary of China was summarized as follows:

The Chinese economy regained enough stability in 1969 to reach, and possibly surpass, the peak output of 1966. Industry apparently has recovered from many of the problems caused by the Cultural Revolution in the past three years, and production in 1969 may be about 10 percent higher than in 1968. In 1970, industry

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could move into new high ground. Dependence on imports of Western equipment for access to modern technology continues. There is little evidence so far that the regime's current campaign for "war preparations" has led to changes in the pattern of Chinese industrial activity.

Agricultural output in 1969, while adequate for current needs, is not likely to provide either improved levels of consumption, sizable increases in the volume of raw materials for industry, or significant increases in agricultural products for export. Imports of grain and fertilizer continue at about the level of 1968. In economic policy the regime still shows no signs of taking the comprehensive measures necessary to stimulate growth in the agricultural sector. 70/

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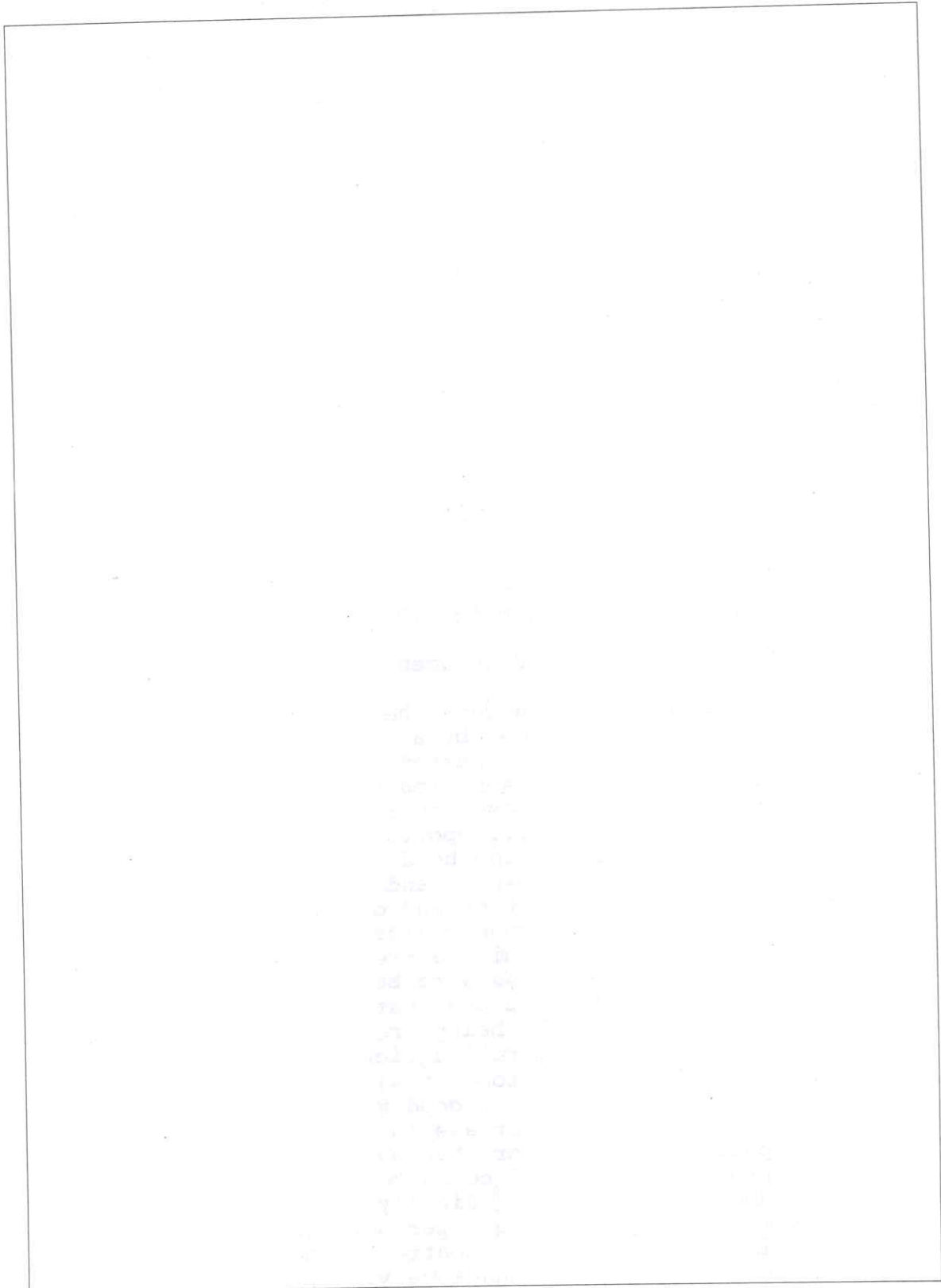
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In the late 1960's, the so-called "Green Revolution" was having a measurable impact on agricultural yields in a number of developing countries. These developments were analyzed by OER's specialists with respect to several Free World countries, and there was, of course, considerable interest in whether the particular set of agricultural inputs that characterized the "Green Revolution" were being effectively applied in China.

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The prognosis in mid-1972 was more favorable.

At this time, the OER judgment was as follows:

industrial inputs into the agricultural sector clearly rose by a substantial amount over the corresponding period of 1971. Increased supplies of chemical fertilizers are based on increased domestic production...imports of chemical fertilizer are being held to previous levels. Pumps, pipes, and other equipment for use in irrigation and drainage projects flowed into the countryside in greater volume, and the Chinese press claimed that extensive additions were being made to high-yield acreage and that large areas of wasteland were being brought into cultivation.... Overall agricultural production in 1972 probably will exceed production in 1971 by a good margin simply because of the increase in industrial inputs. Given better than average weather, production in 1972 could be appreciably above 1971 levels. Finally, the Chinese may now be entering a period when their investment in water control measures will begin to pay off handsomely. 73/

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Chapter IV

VIETNAM

"...the unwritten lessons (of Vietnam) are twisting slowly in the wind."

Herbert Mitgang (Editorial Board)
N.Y. Times, 15 January 1974

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With the consolidation of OER's Indochina-associated research and reporting activities in one division late in 1967, the Office was able to pursue its Vietnam War responsibilities more effectively. These were primarily enemy manpower estimates, bomb damage assessment, enemy supply routes (including routes through Laos and Cambodia), Communist aid shipments to North Vietnam, and assessments of the economies of all countries in the Indochina area, including both Vietnams, Laos, Cambodia, and Thailand.

The personnel commitment to this effort had grown [redacted] ORR's professional production personnel in July 1965 [redacted] in July 1967. During the next year, i.e., until June 1968, this was further increased to about [redacted] professional production personnel. 74/

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The extent of involvement in what was in essence military intelligence by an Office organized, staffed, and chartered to conduct economic research was, to some observers, unusual. It is explained in part by the concentration in the Office of the Agency's specialists in transportation and construction and in a number of functional

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economic activities which support war-making power. Equally important was the fact that the Indochina war was by all counts the most "statistical" in history. The absence of major decisive battles with easily determined victors, of identifiable battle lines, and of the other characteristics of conventional war forced the policymakers to seek other measures of progress. The almost obsessive eagerness of Secretary of Defense McNamara and President Johnson for quantification of every aspect of the hostilities made this particular war a statistician's dream -- or more often a nightmare. OER had not only the technical specialists referred to, but also a growing number of experts in the fast developing field of econometrics, i.e., the application of advanced statistical techniques to economic problems. Such techniques were also found to be applicable to many of the problems of the Indochina war. As a result, statistics on pacification, battalion attacks, ammunition expenditures, Allied and enemy operations, and similar matters were produced with almost mechanical regularity. Computers absorbed these data and massaged and manipulated them in every way that trained and imaginative analysts could

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perceive. Many of the statistical series developed by OER provided valuable insights into how the war was progressing. For example, the series on infiltration of North Vietnamese military personnel to South Vietnam was considered a valuable indicator of Communist intentions. This could not be said, however, of all of the other statistical series on the war. Intelligence analysts who worked closely with the available data soon came to realize that many series had significant biases, some unfathomable, some so severe that the series were of questionable value as analytical tools. This was because most of the statistical measures bearing on enemy activities in Indochina were dependent on human judgments, or based on small samples, or derived from tenuous methodologies. Thus, when the analyst attempted to build "models" by inter-relating several of the series at once, illogical and even nonsensical conclusions frequently resulted. 75/

A. Enemy Manpower and Forces Estimation

The statistical possibilities and pitfalls relative to the Indochina war are well illustrated by the Office's work -- and that of its military counterparts -- on enemy manpower estimates. One

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of the measures used in these estimates was the "gain-loss" methodology. This was essentially a bookkeeping technique, requiring the maintenance of a ledger with one side showing the gains:

1. Infiltrators from North Vietnam.
2. Recruits obtained in South Vietnam.

While on the other side of the ledger were listed the "losses":

1. Killed in action (the body count statistics)
2. All other losses, such as died of wounds, captured, deserted, retired, and so forth.

The periodic balancing of the books should, in theory, show whether the Communist forces in the field had grown or declined and by how much. Such changes in enemy strength should also, in theory, agree with the "order of battle" analysis, which was carried out in a number of different ways. The classical approach was unit-by-unit compilations based on captured documents and prisoner interrogations. Other methodologies were based on the organization of the enemy forces and average unit strengths. Obviously, each approach had its own problems and margins of error. The "average battalion strength" approach, as it was called, proved, however, to be a more responsive indicator of changes in the size of the enemy

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forces in South Vietnam than the "gain/loss" method.*

* The best way of understanding the problems associated with the gain/loss approach is to run through the numbers for several years. First, 1968:

	<u>Thousand Persons</u>
Infiltration	250 - 300
Recruitment	132
Total gain	382 - 432
Losses	-310
Net gain	<u>+72 to +122</u>

Thus the gain/loss methodology would indicate that the Communist forces in South Vietnam grew by from 72,000 to 122,000 personnel during 1968. However, independently derived estimates for the same time period show that the enemy strength in South Vietnam declined by an estimated 30,000 to 40,000 personnel. Thus the gain/loss approach would have the enemy strength greatly increasing at a time when the best evidence was that the strength of the enemy forces had in fact decreased.

Moving on to 1969 and 1970:

	<u>Thousand Persons</u>	
	<u>1969</u>	<u>1970</u>
Infiltration	100 - 120	55
Recruitment	45	35
Total gain	145 - 165	90
Losses	-288	-202
Net loss	<u>-123 to -143</u>	<u>-112</u>

In 1969 the gain/loss analysis indicated that the Communist forces decreased by 123,000 to 143,000 and suffered a further decline of about 112,000 in 1970. [footnote continued on p. 92]

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All the intelligence units that were concerned with this problem -- CIA, DIA, and MACV -- attempted the gain/loss methodology, and the latter two adopted it for a time as the authoritative approach for measuring enemy strength. Their persistence in using it -- particularly MACV's -- after it had been shown to be susceptible to grossly misleading results was a major factor in the long drawn out argument between the agencies on the question of enemy manpower.

In fact, much of the history of OER's Vietnam work can be written in terms of differences between the Office and the military, often including DIA. These were particularly severe in the estimates of enemy manpower.*

In contrast, independent estimates showed that the declines in enemy strength were much less precipitous -- on the order of 60,000 men in 1968 and about 45,000 men in 1970. Thus, the gain/loss approach shows one anomaly in 1968 -- greatly underestimating enemy losses -- and shows the converse in 1969 and 1970. Furthermore, slight changes in some of the underlying assumptions behind the data can result in wide swings in the final results. For these reasons the intelligence community learned through hard experience to view gain/loss analysis with the greatest of skepticism and to reject it as an authoritative analytical tool. 76/

* DIA and CIA moved closer together in 1968; in response to the Nixon Administration's first intelligence community review of the war early in 1969 (NSSM-1) the CIA/DIA estimate was juxtaposed against that of the military in the field (CINCPAC/MACV).

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The dispute on this subject became acute in mid-1967. In September 1967, a conference in Saigon between the concerned agencies seemingly reached an agreement as to methodologies, definition, etc. that would reduce the differences between CIA and the military. This agreement proved illusory; within a month of its conclusion, OER's informed the Director's Special Assistant for Vietnam Affairs (SAVA) that a draft MACV press briefing on enemy order of battle was to be ranked "as one of the greatest snow jobs since Potemkin constructed his village." 77/ He considered it to imply a certitude and precision that were completely unwarranted by the evidence, and in its treatment of the data on VC militia and self-defense forces to be "not a violation of the Saigon agreement [but] a complete and wanton scuttling of the whole exercise." 78/

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A second conference was convened in Washington in April 1968. This conference included representatives from the concerned USIB agencies, CINCPAC and MACV, and observers from the military services. Although all parties made some adjustments in their previous positions, the conference failed to reach agreement on any of the elements included in their

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estimates of every strength. Following the conference, at the direction of the DCI and the Chairman, JCS, a CIA/DIA Working Group worked out an agreed position, but they were unable to get CINCPAC/MACV concurrence. The inability to reach agreement on these estimates arose from basic definitional, and conceptual differences e.g. the gain/loss versus the order of battle approaches, and from inadequacies in the data base. The Saigon side had much narrower criteria of evidence than the Washington side, which not only based its estimates on all-source intelligence, but also included in total enemy forces a wider range of support elements and local irregular forces. As a result the MACV estimate tended to underestimate enemy strengths (vis-a-vis the CIA/DIA estimate if not in actuality) and to lag behind events

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The differences between Washington and the field were thoroughly aired in the agency response to Dr. Kissinger's request for clarification in Question 8 (of 29) for NSSM-1 of 21 January 1969.* The agreed CIA/DIA estimate as of 31 December 1968 on Communist military forces in South Vietnam

* National Security Study Memorandum, No. 1.

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(combat forces, guerrillas, and administrative services) was 265,000 to 355,000; the comparable CINCPAC/MACV figure was 229,000-233,000. 79/

There was also a significant difference in the estimates of Viet Cong recruitments, with CIA's estimate considerably above that of MACV.

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During 1969, the areas of differences were significantly narrowed, although the field commands still did not agree completely to the Washington estimates.

B. Bomb Damage Assessment

Another area of dispute between the Agency (OER) and the military was in bomb damage assessment. As recounted in Volume II, OER became heavily involved in this exercise as the result of continuing requests by Secretary McNamara. This reporting, resulting in the well-known McNamara Reports, was followed in 1968 by the Clifford Reports, which were equally demanding of OER's resources, but less elaborate in detail, possibly because Secretary Clifford was less demanding of detail and because the Office was becoming more sophisticated in its analysis. Also, of course, the bombing activities over North Vietnam were progressively curtailed in 1968.

The differences with the military continued, however. Simultaneous with OER's individual reporting for the Secretaries, joint CIA-DIA monthly (later quarterly) reports were prepared

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on the effectiveness of the bombing. Production of coordinated intelligence on the subject was difficult. As [] expressed it: "The marriage ... is always a bad union, because the CIA interest is for a statement consistent with the McNamara reports (i.e. reflecting its independent judgments) and the DIA interest is in a statement emphasizing damage and disruption." 81/

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Although coordination with DIA improved with respect to the bomb damage assessments as it did with respect to enemy force levels, [] who was given the major responsibility for the Office's work with the Vietnam problem for most of the period of this history characterized the problem on a later occasion as follows:

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The problem arises from the conflicting pressure within DIA on the one hand, to present the best possible input into national intelligence and on the other hand to conform with and to support the intelligence judgments of the military services and field commanders. This dilemma has several untoward results. DIA frequently feels compelled, for example, to espouse viewpoints of field commanders with which it does not agree. Or, in seeking to accommodate divergent views, DIA produces intelligence that inadequately presents the views of either side. This situation in one famous instance -- the enemy strength debate -- delayed for over 15 months the production of highly significant national intelligence. 82/

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OER's overall bomb damage assessment as presented in the McNamara Report series* was not significantly altered in 1968. As summed up in the Office response to NSSM-1, it was as follows:

The major effects of the bombing of North Vietnam were extensive damage to the transport network, widespread economic disruption, greatly increased manpower requirements, and the problems of maintaining the morale of the people in the face of personal hardships and deprivation. Hanoi was able to cope effectively with each of these strains, so that the air war did not seriously affect the flow of men and supplies to Communist forces in Laos and South Vietnam. Nor did it significantly erode North Vietnam's military defense capability or Hanoi's determination to persist in the war. Material losses resulting from the bombing were, for the most part, offset by increased imports from Communist countries. Damage and destruction by the bombing of military and economic facilities and equipment, together with measurable losses of output, were valued at about \$500 million. Economic and military aid during 1965-68 is estimated at over \$3 billion. 83/

C. The Interdiction Issue**

Another significant OER contribution in the Indochina situation was research in depth and

* See Volume II, Chapter V for a discussion of this series and its findings.

** This section is concerned with the interdiction of supplies to North Vietnam proper; the equally important problem of supplies to North Vietnam forces and rebels in South Vietnam is considered in the section following.

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reporting on the scale of outside Communist aid to North Vietnam, its content, and its movement. The latter two points, in particular, were of considerable interest to policymakers and interdiction planners. This Office activity over an extended period included many ad hoc reports in response to specific requests as well as monthly wrap-ups of shipping to North Vietnam. It is, therefore, difficult to summarize, except in very general terms. A major point that OER could make with considerable confidence through most of the period was that combat materiel* was in all probability moving to North Vietnam overland through China rather than by sea.

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* The term combat materiel refers to lethal weapons such as artillery, small arms, ammunition, surface-to-air missiles (SAM's), and military aircraft. It does not include military support items such as trucks, barges, and helicopters, which have been shipped to North Vietnam by sea.

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materiel was moving overland from China to North Vietnam. 84/

This was not to say, of course, that seaborne trade was not important to North Vietnam's ability to carry on the war. About 85 percent of its imports arrived by sea, including necessary food-stuffs and petroleum. OER consistently maintained, however, that all this could be diverted to overland routes. Since a sea blockade or other interdictions were continuing policy option considerations during the course of the war, OER's judgments about their possible impact were often sought. This was one of the several subjects addressed in the Office response to NSSM-1 early in 1969:

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All the war-essential imports could be brought into North Vietnam over rail lines or roads from China in the event that imports by sea were successfully denied. The disruption to imports would be widespread but temporary . . .

Almost four years of air war in North Vietnam have shown -- as did the Korean war -- that, although air strikes will destroy transport facilities, equipment, and supplies, they cannot successfully interdict the flow of supplies because much of the damage can frequently be repaired within hours. . . .

An intensive and sustained air interdiction program could have a good chance of reducing the northern rail capacity by at least half. However, roads are less vulnerable to interdiction, and waterways even less so. . . .

In addition to the overland capacity, an airlift from Chinese airfields could potentially provide a means for importing a large volume of high-priority goods. Moreover, total interdiction of sea-borne imports would be difficult because shallow-draft lighters could be used to unload cargo from oceangoing ships anchored in waters outside the mined major harbor areas.* 85/

Again in the fall of 1969, the Office view was that

* Most of the quoted excerpts were made public in May 1972, following President Nixon's decision to bomb in the Hanoi-Haiphong region and his orders to mine North Vietnam's harbors. The release was made by Senator Gravel (D-Alaska) in an attack on President Nixon's decision. According to the press, Kissinger then said the CIA view expressed in the 1969 response had been carefully considered but that the decision had been made following recent and "much more detailed" studies. 87/

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The diversion of North Vietnam's sea-borne import traffic to overland routes via China is well within the capabilities of the transport systems of China, the USSR, and North Vietnam . . . the disruption (of a mining program) should not exceed 2-3 months. 86/

D. The Cambodia Problem

Another major substantive disagreement between the Washington Intelligence Community -- CIA (later joined by DIA and State) -- and MACV concerned the role of Cambodia in supplying enemy forces in South Vietnam. This issue lasted from 1965 until its resolution in mid-1970

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During the first part of this period -- up to December 1966 -- OER concluded, correctly, that no significant volume of military supplies was reaching the enemy from Cambodia.

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[REDACTED] OER acknowledged an increasing likelihood that Cambodia was being used as a channel for military equipment reaching those areas. [REDACTED]

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This judgment, which was coordinated with both INR and DIA, was expressed first in an Agency memorandum, [REDACTED]

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later in an Intelligence Memorandum released in July 1968. In the words of the latter publication,

There is increasing evidence -- albeit mainly circumstantial -- that Communist forces in the III and IV Corps areas of South Vietnam are receiving an important share of their arms and ammunition via southeastern Cambodia. 88/

After OER conceded that Cambodia was a significant source of arms for the Communists in 1968 and that it involved the organized acquiescence and cooperation of elements of the Cambodian Army, there remained serious differences with MACV regarding the importance of the Sihanoukville route. A joint CIA-State-DIA team, headed by [redacted]

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[redacted] of ONE, visited Indochina in late 1968 to study the matter.* The report of this group concluded that:

"The evidence available does not offer positive proof that any one of the routes (the overland route through Laos or the route through Sihanoukville now carries the bulk of the required arms and ammunition to III, IV, and Southern II Corps. All things considered, however, we believe that the overland route is the basic channel for the movement of arms and ammunition to Communist forces, not only in I and II Corps but also in III Corps". 89/

MACV and CINPAC continued to view the Sihanoukville route as the more important, and for the next

* OER was represented on the team by [redacted]

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eighteen months, the search for evidence to resolve the issue went on.* Until July 1970 when the unearthing of documentary evidence showed that Sihanoukville was in fact the route responsible for the bulk of supplies going to Southern II, III, and IV Corps, the controversy between the Washington Community (i.e., CIA, DIA, and State) on one side and CINCPAC and MACV on the other was unresolved. The Washington Community view was succinctly stated in the CIA (OER) response to NSSM-1, early in 1969: (With respect to the overland route) --

Although the tonnage of military supplies delivered to the Panhandle of Laos is sufficient to provide all of the requirements of the Communist forces in South Vietnam for military supplies from external sources, the overland route to III Corps is long, tedious and costly. For this reason forces in these areas rely on other external sources as a supplementary means of supply. The preponderance of the evidence, however, supports the estimate that the basic channel for the supply of III Corps is the overland route from Laos. Intelligence on shipments south to the tri-border area, the efforts to improve roads and trails, the use of the trails for

* The great attention given to this issue resulted from

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personnel movements, and periodic reports of logistic activity along the trails are reasonably convincing. In addition, we believe that our knowledge of the organization for logistic support is sufficient to show that its orientation is toward Hanoi via Laos. [REDACTED]

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(With respect to the Sihanoukville route) --

We believe that one cannot ascertain what portion of the military supplies reaching VC/NVA forces via Cambodia comes through Sihanoukville. Aside from a lack of precise and reliable information on the cumulative amount of military supplies reaching the Communist forces in South Vietnam through Cambodia regardless of point of origin, we have no reliable estimates of the total tonnages of arms and ammunition arriving at Sihanoukville or the volume of such materiel required by Cambodian Armed Forces. Although we know that Cambodia has been re-equipping its armed forces with Chinese and Soviet materiel in recent years, we have no measure of the quantities issued, stockpiled, or expended. Those military deliveries from Communist China and the USSR which have been identified, however, appear to be consistent with contracts acknowledged in recent years and to be plausibly associated with the re-equipment program.

(With respect to the MACV position) --

(1) We do not believe that the intelligence available is adequate for firm estimates of either deliveries of military supplies to Sihanoukville or Cambodia's requirements for military supplies. The methodology used by MACV to determine military deliveries does not distinguish between arms and ammunition and other types of military supplies.

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(2) We have serious reservations about the validity and reliability of many sources used by MACV to document its case and do not believe that these sources can be used to quantify the movements from Cambodian sources to NVA/VC forces.

(3) We estimate that the interdiction campaign in Laos has not been able to reduce the flow of supplies from North Vietnam through Laos to South Vietnam to a level that is not adequate for the needs of the Communists in at least the I, II, and III Corps areas of South Vietnam.

(4) Finally, although we concede that the Communists probably would take advantage of a means of channeling arms through Sihanoukville, we doubt that they would use a logistic system under foreign control as their primary supply route. 91/

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[REDACTED] the estimates finally arrived at in this reevaluation of the evidence for the Sihanoukville route were still considerably lower than those of MACV and tended to support the conclusion that the overland route was indeed a major part of the total equation.

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[REDACTED] It was finally clear that starting in December 1966 an elaborate logistical system had been developed based on Chinese Communist shipments unloaded at Sihanoukville and delivered to VC/NVA base camps in Cambodia.

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(b)(3)**E. NSSM-1**

The advent of the Nixon administration and the appointment of Henry Kissinger as the President's Assistant for National Security Affairs brought

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a new type of policy support vehicle to official Washington. This was the National Security Study Memorandum (NSSM). The first of these was, understandably, addressed to the problem of Vietnam. For NSSM No. 1 of 21 January 1969, Kissinger posed 29 key questions on Vietnam for separate response by the Agency and the Departments of State and Defense. The Agency responded to 27 of these -- the other two being addressed to US Forces operational concerns. Of the 27 CIA responses, OER had major responsibility for more than one-third.* The Office responses covered assessments of Soviet and Chinese aid to North Vietnam, the adequacy of Hanoi's manpower reserves and the ability through infiltration and recruitment to offset attrition of their forces in South Vietnam, VC/NVA order of battle, supply channels through Cambodia and Laos, analysis of bombing effects on the supply routes, on VC/NVA operation in South Vietnam, and on the support capabilities in North Vietnam. 93/

Thereafter the demands on OER for Vietnam support were, if anything, even greater than they had been during the Johnson Administration.

* Several of the OER responses have been quoted in the preceding sections of this chapter.

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or his surrogates, were in frequent attendance at the various meetings called by Kissinger and the special groups established by him to report on the progress of the war, to assess the probable results of various courses of action, and to provide intelligence judgments on a wide range of Vietnam-related problems. Many of the resulting tasks laid on the Office were remote from the traditional concerns of economics.

F. NSSM-99

Kissinger's needs for detailed analysis, which was apparent early in 1969, called for a more intensive and more sophisticated attack on Vietnam issues by the Office. The gradual disengagement of US forces and the involvement of Kissinger in secret negotiations eventually created a new environment in Indochina and led to new types of questions. These questions forced OER to develop new methodologies and approaches to satisfy Kissinger's desire for more detailed and balanced assessments of the overall military situation in Indochina as opposed to the more limited numerical manipulations of enemy strengths and weaknesses that characterized the earlier effort.

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A major element in this new effort was NSSM 99, a series of reports prepared over a period of about 12 months by the Vietnam Special Studies Group (VSSG).^{*} Begun in 1970, NSSM 99 first addressed three possible strategy options for Cambodia involving future Allied diplomatic, military, and economic actions. Although OER had been involved in analyzing the Cambodian situation for some time, this paper went far beyond previous studies. Rather than focusing on the narrow question of Cambodian supply routes, OER was asked for the first time to make an overall assessment of the situation in Cambodia, and to postulate the consequences of future allied actions.

Questions on
ARVN and RLAF unit strengths, air capability, and training were raised, many for the first time, and OER analysts frequently broke new ground in re-searching them. These reports were often written under very short deadlines

^{*} The VSSG was created by President Nixon in October 1969. Staffed by senior members of the various intelligence agencies, it became one of the main conduits for OER reports desired by Kissinger and other high-level consumers.

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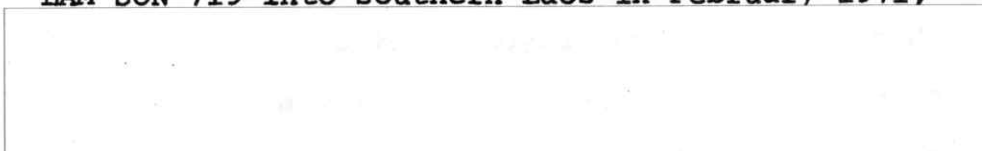
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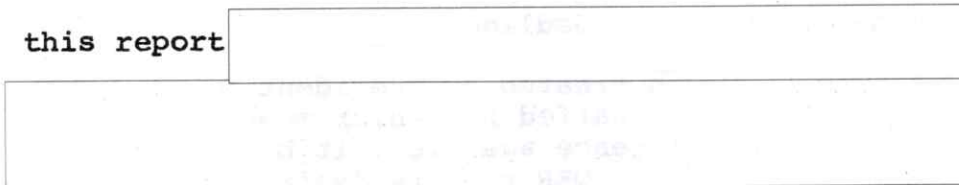
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made the
effort a particular rewarding one for the analysts
involved.

South Vietnamese forces launched operation
LAM SON 719 into southern Laos in February 1971,

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One of the highlights
of this period was a report analyzing the effects
of LAM SON 719 on North Vietnam's ability to con-
duct large-scale military action in South Vietnam
during the rest of 1971. This report concluded
that Hanoi's ability to undertake major military
action was probably impossible during 1971, and
that a major resupply campaign would have to be
undertaken before any offensive could be launched
in 1972. 94/ Hanoi's March 1972 offensive conformed
to this timetable and bore out the conclusions of
this report

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During this period, OER participated in a number of reports analyzing possible cease-fire scenarios. Several sensitive studies dealing with the cease-fire were prepared and, although these questions seemed quite abstract at the time [REDACTED]

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From the fall of 1971 until March 1972, growing

[REDACTED] indicators of Hanoi's intention to launch an offensive sparked repeated requests from [REDACTED]

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[REDACTED] high-level consumers for detailed assessments. These reports drew upon analytical and statistical procedures which had been developed previously but went well beyond earlier reports in scope and detail. [REDACTED]

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This effort was highlighted [REDACTED] which

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went far beyond the usual factual presentation and contained analytical assessments more characteristic of a national estimate than of the typical OER report. 96/

Still another refinement of OER's ongoing research contributions came in April 1972 [redacted]

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[redacted] a comprehensive report on the balance of military forces in South Vietnam -- not just assessing enemy capabilities, but the capabilities of the South Vietnamese as well. The report, which was published just after the North Vietnamese launched the 1972 spring offensive, stood up remarkably well as fighting continued during the summer and fall months.

The Hanoi-Haiphong area bombing of mid-April 1972 was followed by the mining of North Vietnam's harbors early in May. These activities evoked a heavy support response from OER's [redacted] analysts, as well as a number of crash projects, assessing the capabilities of the USSR and China to supply North Vietnam by air, railroad, and pipeline through China. [redacted]

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[REDACTED]

Shortly thereafter

the Office resumed to comprehensive bombing assessments [REDACTED] -- an activity in which the experience gained from preparation of the earlier series of McNamara Reports proved useful.* [REDACTED]

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* See Volume II, p

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As the period covered by this history drew to a close in July 1972, OER's capability to supply finished intelligence on matters connected with the military operations in Indochina continued to be in heavy demand, and although there also continued to be differences with military intelligence producers in the field and -- to a lesser extent -- with DIA, the OER product appears to have been well received in the White House -- if not in the Pentagon. 99/

The cease-fire settlement in January 1973, although beyond the scope of this history, is of interest because it resulted in OER's being tasked to produce a weekly series of cease-fire logistic and manpower developments, as well as a comprehensive study, together with DIA, of North Vietnam's military order of battle. [REDACTED]

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[REDACTED] The continued high level of analysis and reporting in the post-cease-fire era has been accomplished with relatively few military analysts -- a feat which reflects the high degree of professionalism built up in OER over the years on this subject.

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~~SECRET~~G. Economic Intelligence on South Vietnam

Although perhaps less pressing than the intelligence support of US military operations, the Office's reporting on economic conditions in South Vietnam continued throughout the period 1967-72. This reporting was contained in monthly economic situation reports, which provided current summaries and gave, in the later stages, some perspective and consideration to post-war problems. In addition to current reporting on the South Vietnam economic scene, the Office provided agency representation on interagency committees dealing with measures to stabilize South Vietnam's economy on a current basis and to provide a foundation for the economy to carry on over the longer term. In 1971, this effort was highlighted by a major research product in support of an NSC study on the problems and options related to economic development in South Vietnam.

The results of this research effort, initially prepared as a contribution to the NSC Vietnam Economic Development Fund study, were published as well in an Office Intelligence Report. 100/ This report included projections of the foreign capital requirements and the economic policy changes necessary to achieve given growth rates during the 1970s. On

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the basis of these projections, the report outlined several practicable development strategies for South Vietnam. The report thus formed the basis for continuing discussions and further support activity in 1972 by the Office's economic planners working with concerned agencies represented on the VSSG's Economic Panel on South Vietnam.

These discussions and support activity, together with the great variety of logistic studies, bomb assessment studies, and other operational intelligence support, made it necessary for the Office to continue a significant allocation of resources to Indochina at the time of its 1972 reorganization. The reorganization, which was long overdue in the light of major shifts in the other responsibilities and workload of the Office, had been put off in the hope that the Vietnam War's drain on economic intelligence resources would evaporate. Because in mid-1972 there was little reason to expect that this evaporation could soon be expected, the Indochina function continued to justify a division-level operation.* As of mid-1972, about [] of the Office's personnel resources and about [] of its production were concerned with the Indochina War.

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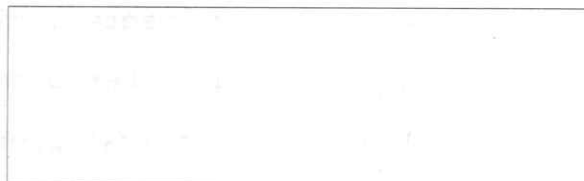
* The reorganization of August 1973 -- more than six months after the Vietnam cease-fire -- also continued a division-level effort on Southeast Asia -- primarily Indochina.

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Chapter V

THE DEVELOPING WORLD



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late 1960's, however, the Third World countries had acquired status as economic intelligence targets in their own right. Concern with Communist influence therein remained, as it often was a factor in internal developments, but the broad policy support orientation of the Office led to consideration of a much wider range of problems. A growing realization of the limitations of US -- and other foreign -- aid effectiveness had developed. This combined with a heightened awareness of the interlocking characteristics of poverty, overpopulation, and other economic factors with political and sociological problems and a growing concern about the US need to protect its own interests in these countries and their strategic resources. In addition, US humanitarian sensibilities have been touched by suffering and starvation in the

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wake of civil wars, floods, droughts, earthquakes and other disasters that have all-too-frequently afflicted the peoples of the developing world. In short, the need for economic intelligence research and analysis in realms unthought of by ORR's architects had in the 1967-1972 period a major impact on the Office's resources. The application of these resources [redacted]

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[redacted] to the problems of the developing world is summarized in this chapter.

B. Latin America

Although the Office's Latin American unit has, since its organizational birth as the Cuba Branch in January 1962, [redacted]

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[redacted] After only five months of existence, the branch was renamed Latin America Branch and,

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[redacted] For a number of years it had the distinction of being the only branch with a foot in both Free World and Communist camps.

From mid-1962 on, the branch [redacted]

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out the usual NIS and NIE support, monitored Communist aid programs, and reported on the ups and downs

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The problems were not necessarily limited to Communist influences or machinations. If reports such as 1965's The Deepening Banana Crisis in Ecuador 101/ did nothing else, they illustrated the global character of the Office's expanded responsibilities and gave evidence that it could and would evaluate economic events far removed from the strengths, weaknesses and capabilities of the major Communist target countries.

1. Cuba

The unique interest in Cuba as a problem for US policymakers, because of its Communist orientation and its geographic and historic ties to the United States, reached its apogee at the time of the Cuban missile crisis in 1962.*

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* See Volume II, Chapter II.

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If

Cuba had ever been expected to stand out as a Communist economic showplace in the Western Hemisphere, it turned out to be a dismal failure. In spite of over \$2.5 billion in economic aid (through 1970) and an additional \$1 billion in sugar purchase subsidies from the Soviet Union, in the 1960's the economy stagnated while consumption declined. In summing up the 12 years of Castro's rule early in 1971, [REDACTED]

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[REDACTED] OER placed the blame for Cuba's economic difficulties largely on Castro's doctrinaire disregard for basic economic principles.

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2. The Problem of Economic Nationalism

Latin American problems have typically stimulated a policy interest -- again probably for

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geographic and historic reasons -- considerably beyond their intrinsic economic importance. There has been, of course, a particular US economic interest in Latin America because the bulk (about 70 percent) of US direct investment in the less developed countries is concentrated there -- over 80 percent if petroleum investments are excluded. The United States has had through its investments and its role as a market for Latin American raw materials and agricultural products a major influence on the economies of the region. Since the mid-1960's rising economic nationalism, including a number of takeovers of US business installations, has threatened US investment in Latin America -- as well as in other LDC's.

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The 1968 case of particular interest was Peru, where a new military junta seized the International Petroleum Company installations in October 1968.

Peru, like many Latin American countries, is heavily dependent on its economic ties to the United States. These ties are not only an important

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source of what economic well-being the country has occasionally enjoyed but also the source of considerable nationalist resentment and thus a ready target for political exploitation by domestic leaders. Often when unpalatable economic programs have been undertaken in response to the chronic inflationary problems, US "imperialism" has been made the scapegoat, and nationalistic pressures have led to various restrictions on US (or other foreign) economic activity. In the extreme cases, expropriations of US properties, often without compensation, have resulted. Such actions, whatever their domestic political attractiveness, have rarely been helpful economically. They have among other consequences, made the expropriating country subject to US legislative requirements that US aid be terminated for a recipient country which fails within six months to take steps toward adequate compensation. In the case of Peru, a similar US legislative provision called for eliminating the subsidy it received under the US sugar quota.

The Peruvian case was analyzed by OER in a series of reports during 1968 and 1969. The first, issued soon after the IPC expropriation, pointed

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out the adverse effect that expropriation would have. Even with adequate compensation, pending US aid and IMF credits would be delayed and the debt servicing burden would be increased. 103/ The report recognized, however, that the Peruvian action was reflective of a trend in Latin America and elsewhere among the LDC's toward actions aimed at increasing their share of the benefits accruing from the exploitation of their mineral resources. 104/

These points were elaborated upon in the spring of 1969. The US sanctions due to take effect in April were suspended indefinitely in the hope that the issue could be resolved in negotiations between the company and Peru. 105/ Such hopes were not realized. In fact, the regime went considerably further over the ensuing months with an expropriatory land reform program (which included some US-owned sugar estates), nationalized the Peruvian Telephone Company (an ITT subsidiary), and issued a series of decrees aimed at progressively reducing the scope of foreign-owned business in Peru. The application of the US sanctions (under the Hickenlooper and Sugar Act

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amendments) continued to be indefinitely suspended. Most US Government aid since the nationalization programs have been in force has, however, been of a relief nature. In May 1970, a devastating earthquake occurred, and the United States, in the humanitarian tradition, led all countries in providing emergency and rehabilitation relief.

The Peruvian situation was again summarized by OER in August 1970. It noted that the economic reforms of the Velasco regime continued to enjoy public support, presumably reflecting the popularity of the regime's themes of nationalism and greater economic and social equality. But the major repercussion of the reform program was continuing economic stagnation -- partly offset by the more than \$100 million received for earthquake relief and rehabilitation. 106/

Over the next two years, the Peruvian government modified its radical programs and moved to restore confidence among foreign investors. As a result, by mid-1972 considerable new foreign interest was being demonstrated. Private foreign capital was returning, including some from the United States, but the IPC issue remained

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unresolved. Thus, in the words of OER's analysis of the Peruvian situation in July 1972:

Fallout from the uncompensated expropriation of a US-owned oil company four years ago continues to block some official foreign loans ... and further difficult choices between socio-political and economic goals loom ahead. 107/

3. Chile

The threat of expropriation on a considerably larger scale also hung over US interests in Chile during the presidency of Eduardo Frei (1964-70). The program of social reforms carried out under his rule took its toll of the Chilean economy, and OER's reports in 1969 and 1970 reflected not only gloom about Chile's economic prospects but a warning that pressure on foreign-owned property, specifically the US copper holdings, in the form of a grab for a larger share of the earnings or outright expropriation was possible. 108/ The concern over this possibility grew as the September 1970 elections approached with two of the three viable candidates considerably to the left of retiring President Frei.

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Although considerably more than half of the US direct investment was in mining and smelting, there was, in fact, much more than copper involved. Two days after the Marxist candidate, Salvador Allende, was elected on 4 September 1970, OER's report on the US financial stake in Chile was released. In addition to listing over 100 US firms or subsidiaries, or affiliates in Chile, this report estimated the value of US private assets in Chile as about \$1.5 billion (book value \$800 million). This figure, together with US Government loans outstanding of \$900 million, meant that a US public and private financial stake in Chile of at least \$2.4 billion was under threat.* 110/

Allende did not take office until 3 November 1970. He was to take over an economy already well

* According to [REDACTED] then Chief of OER's Latin American Branch, the release of these figures created quite a stir since few of the concerned policy officials in Washington had anything but a hazy idea of the size of the stake involved. That OER was able to make such an estimate with speed and confidence is attributed by her not only to the exhaustive efforts of her branch [REDACTED]

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on the way toward the liquidation of the private enterprise sector, except for the small service enterprises. The nature of his economic inheritance was spelled out by OER in October with an assessment of his likely progress toward the complete establishment of a state-controlled socialist economy. 112/ Since there was little doubt that the substantial US interests in Chile would be in severe jeopardy, OER's policy customers were eager for an estimate of the feasibility and probable success of US countermeasures. [REDACTED]

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[REDACTED] followed by a more definitive review of Chile's economic vulnerabilities in February 1971. The latter, a closely held assessment distributed to only seven customers, did not differ from the others in discouraging direct countermeasures.

US economic leverage is small in Chile, and economic sanctions would probably be of limited impact on Chile's economy over the next year or two. The United States took only 17% of Chile's exports in 1969 (and probably less in 1970), and most of these could be sold in other markets. The United States has been a major supplier

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of capital goods to Chile, but blocking future sales would have only a small short-term impact because Chile would be able to purchase similar goods from Western Europe and Japan. Sanctions would probably improve Chile's financial position in the short run because they would give Allende an excuse to default on US public and private loans. Disbursements on these loans at most will probably run only \$30-\$50 million in 1971, while scheduled repayments, interest, and called loans probably will exceed \$100 million.

In sum, traditional economic sanctions such as those used against Cuba probably would have little immediate adverse impact on Chile. Indeed they could be counter-productive. Sanctions would give Allende an excuse to tighten his political control, boost his popularity locally, and increase sympathy for his regime internationally as well as cause Chile to move more rapidly to strengthen its ties with the Soviet Union and Eastern Europe. 114/

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Some reports had been published on the Chilean economy between the Allende election and December 1972. The last of these made the following judgment:

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To many observers, Chile under Allende has seemed like a profligate who frittered away an inheritance on a two-year binge. This consumption spree has cost the country some \$550 million in foreign reserves, a large part of its material inventories, a serious deterioration in productive capacity, and a drying up of most foreign credits. In the process, Allende has used economic levers to radically alter Chile's power structure in an attempt to make his socialist revolution irreversible. Although his policies have created massive government deficits and excess consumer demand, they also have markedly increased the state's economic power and have redistributed income, thereby eroding the opposition's economic base. . .

The economy already is far worse off than when Allende launched his revolution of "meat pies and red wine." Output in most sectors is now stagnating or declining, foreign reserves are heavily in the red and copper earnings down, food stocks and manufacturers' inventories are virtually exhausted, and distribution snarls are chronic. Demand, however, continues to rise sharply, fueled by wage increases, ever-larger government deficits, and a mind-boggling rise in money supply. As a result, even government-controlled prices have jumped almost 75 percent in the last three months, while shortages abound and the black market has become far more a way of life than ever before. ...

Even though Allende's long-heralded year of sacrifice will begin in 1973, investment will remain depressed and output is likely to stagnate or decline. If the regime continues its reckless budget and wage policies in the face of contracting resources, Chile's market system will move further along the road to destruction. Runaway inflation, rationing, or some combination of the two may not be far off. 116/

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With specific reference to Chile's copper industry, a later report noted:

Once the world's lowest cost producer, Chile has become the world's highest cost producer in recent years because of inept management, featherbedding, technical problems following nationalization, and artificially low exchange rates. 117/

4. The Middle East

OER was established in mid-1967 just after the "Six-Day War." This event and its aftermath occupied the attention not only of the Near East Branch but also of many of OER's [REDACTED]

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[REDACTED] specialists throughout the summer of 1967. Also involved were analysts dealing with countries whose trade had made heavy use of the Suez Canal. As noted in Volume II, some [REDACTED] memoranda were produced between the middle of May and the end of June -- mostly in response to requests [REDACTED]

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[REDACTED] and other policy-level consumers. These papers were concerned not only with the economic impact of the damage suffered by the combatants and inflicted on the economies of countries in the region but also with the broader considerations of the impact of the closure of the Suez Canal on

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other countries around the world, particularly the impact on the international movements of petroleum supplies.

Following the hostilities, the reactions of the Soviet Union to the defeat of its protege, the UAR, were of particular concern. [REDACTED]

[REDACTED]

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assessed the impact of the Soviet military aid program on the Arab-Israeli military balance. [REDACTED]

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by April 1968 -- that is, after less than a year -- the military balance that existed just prior to the Six-Day War had been virtually restored except for some support equipment. This, of course, amounted to a heavy Arab advantage in most categories of military equipment, although the Israeli forces' motivation, leadership, and training caused the Office to adjudge them as continuing to outweigh the Arabs in operational effectiveness. 118/ Subsequent estimates of the Israeli-Arab military balance supplied considerable detail as to the measurable ratios of specific weaponry available to each side, but

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did not materially alter the judgments about the Israelis' qualitative superiority. 119/

The cost to Israel of retaining the captured Arab territories and the economic outlook for the East and West Banks of the Jordan were also assessed. The principal point made in the former case was that the economic costs to Israel of occupying and administering the Arab territories was so small that there was no significant economic pressure from this source to influence Israel's willingness to settle Arab-Israeli differences. In fact the military advantages of more defensible borders easily out-weighed any economic costs. 120/

Another major category of analytical activity in the aftermath of the Six-Day War was the assessment of its impact on the economies of the region. Israel's economy suffered little direct impact except for a brief period and for the occupation costs referred to in the preceding paragraph. The Israelis' economic problems, despite the remarkable progress since 1948, were of a more fundamental nature, stemming from a dependence on large foreign remittances and immigration. The forecast for Israel was for a continuation of

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these economic infusions. This would postpone the structural reforms -- e.g., development of competitive exports -- necessary to overcome the basic weaknesses of the economy. 121/ On the other side, the Arab states' economies had suffered in varying degrees. Egypt and Jordan felt the principal impact, somewhat alleviated by aid payments extracted from the oil-rich states at the Arab Summit Conference held in Khartoum from 28 August to 1 September 1967. 122/ As for the others, a number suffered from a loss of tourist trade (Lebanon, Tunisia, and Morocco) or from temporary disruption of the oil trade.

In the later years of the period covered by this history, the Office's specialists on the area continued to assess the relative strength of the contending parties without, as noted above, altering the judgments of the earlier years.

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C. Africa

Mention has already been made in Volume II of the genesis of economic intelligence research on

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Africa by the Office, as well as of some of the problems encountered and of some major policy areas of concern. During the years covered by this volume, African problems were overshadowed by the more pressing demands of policymakers relative of other parts of the world. Nevertheless there were a number of contributions made in African economic research during this period.* In addition to the studies of individual countries and of such crises as the Biafran food relief problem** a number of substantive issues characteristic of Black Africa as a region were considered.

One of these was an analysis of agriculture, food, and population in Africa. [REDACTED]

[REDACTED] the ability of African agriculture to feed rural and urban populations and produce cash crops for export in sufficient volume to pay for import needs. [REDACTED]

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* Not the least of the contributions of the Africa Branch has been as a training ground for senior positions in the Office. [REDACTED]

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** See Chapter II, Section D.

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[redacted] in the absence of prolonged civil disturbances or natural catastrophes, African agriculture would be able to satisfy these needs through 1975 and probably through the succeeding decade. 123/

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Later in 1970 the Office published an analysis of urbanization in Black Africa as a social and economic problem of major proportions for the region. 124/ Although Black Africa's urban population in 1970 was estimated at about 10 percent of the total population, compared with a world average of about 25 percent, it was growing faster than in any other major region. The principal reason for this growth was rural-urban migration. The attractions of city life contrasted with the hard and unrewarding life in the villages were found to be offsetting the disincentives of probable under-employment or unemployment for most migrants to the cities. [redacted]

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[redacted] 125/ This phenomenon was creating problems of urban unemployment, housing shortages,

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and pressures on urban health and education facilities; all of these problems were, of course, potential threats to social and political stability.

Other regional approaches to African research included consideration of Africa's growing role in the world iron ore trade. The Office report on this subject pointed out that Africa increased its share of world iron ore exports from 13 percent in 1960 to more than 23 percent in 1969 and forecast a doubling of African production in the next ten years. With a caveat that "political and economic stability will be principal factors influencing the role of Africa in world iron ore trade," it predicted a "large share of the world's iron ore market for the African areas." 126/

Another African project of politico-economic interest was prepared in the fall of 1970. This was an effort to analyze the validity of the often-voiced proposition that South African racial policies placed a burden on the economy by creating a manpower shortage that restricted economic growth. 127/ The question was not only of intrinsic interest, but its analysis by means of the production function is another illustration of the

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increasing use by the Office of modern economic theory and techniques in addressing economic issues of policy concern.

The overall cost of apartheid could not be measured, because the long-established system of discrimination has for many years pervaded the entire economy, influencing the sectoral distribution of labor and capital, the technology, the educational system, the composition of trade, and the pattern of demand. It was, however, considered possible to approximate its cost with respect to the allocation of new resources. This was done by estimating the difference between the potential growth of output in South Africa under apartheid and the growth that might be achieved with a free labor market. The alternatives of each system were analyzed by equations representing the restricted labor market production function and the free labor market production function.*

The results of the study did not offer much encouragement for the view that economic forces would soon bring about a change in South Africa's

* For a description of these production functions, see the methodology appendix of the referenced report.

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racial policies. Apartheid could not be shown to exact a significant economic cost. The calculations indicated that maintaining the existing system retarded the annual growth in GDP by only 0.2 percent from what could be achieved in a free labor market situation; even this small economic cost was borne by the non-whites. Where it had the most potential for adversely affecting the white rulers, i.e., in manufacturing, this was mitigated by lax enforcement of the apartheid laws. 128/

This publication excited considerable interest among the government's Africa policy officials.

The author, [REDACTED] was requested to give a number of briefings on his methodology [REDACTED]

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D. The Sub-Continent

Two major areas of interest in the sub-continent occupied OER's South Asia Branch and supporting elements during this period. Indian economic problems, primarily food and population pressures, and the disintegration and ultimate break-up of the Pakistan Union.

1. Indian Food Problems

The supporting contributions made by ORR at the time of India's severe drought in 1965, which

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resulted in massive shipments of US wheat, have been outlined in Volume II. In the following several years the combination of good weather and a number of technological advances, popularly known as the "Green Revolution," brought substantial crop gains in India and neighboring countries, leading some observers to euphoric expressions of belief that an agriculture revolution was under way in Asia. 129/

The publicity that was given to spectacular increases in yields of wheat and rice using newly developed seed under experimental conditions overshadowed the more sober judgments that a true Green Revolution would also require substantial investment in other inputs, such as appropriate applications of fertilizer, effective water control, and sophisticated cultivation methods. OER's reports on the Indian food problem as well as on the manifestations of the Green Revolution in other parts of Asia stressed these later factors and tended to warn that the high-yield variety (HYV) seeds were not a panacea for the world's food problems.

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only about 30 million of India's 400 million acres of cultivable land have sufficient water, even under irrigation, to make HYV seeds an economic proposition; that a HYV rice seed adaptable to Indian conditions and taste preferences had not yet been developed; and that government support for the program was sporadic. Thus the likelihood of a sustained breakthrough to an assured self-sufficiency in grains was unlikely. Since the Office estimates of the success of India's birth control programs were also on the pessimistic side, it was forecast that, at best, future growth in food production would be barely in excess of population growth. Because of the dynamics of the food-population dilemma, this would mean a continuing and growing need for imports, possibly reaching an average of 10 million tons annually by 1980.

An added problem, which came to light sometime later, was the diversion of India's better irrigated land away from industrial crops to foodgrains.

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The resultant decline in yields of cotton, jute, and oilseeds was having a serious impact on India's economy and particularly its foreign exchange earnings. 131/ In short, the so-called agricultural revolution in Asia was not, at least for India, living up to the advance billing that its prophets had put forward in 1968.

2. Pakistan and Bangladesh

The Pakistan Union had been regarded by most observers since its creation in 1947 as a geographic, political, ethnic, and economic anomaly. On the purely economic front, however, OER's analysis in 1970 pointed to economic benefits accruing to the union for both east and west wings:

The Pakistan political union benefits economically both the East and the West. Each region rapidly expanded its production of goods for the combined market, a process greatly assisted by tariff walls and by the ability to specialize because of diverse agricultural resources. The flow of capital and entrepreneurs from the West benefits the East which sorely lacks these development ingredients. On the other hand, the West obtains relatively large profits from investments in the East....

However, the income disparity has grown...because of marked basic differences in resources. The East suffers from severe population pressure and lacks human skills as well as adequate water control. Little progress is possible without a

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major and enormously expensive flood control program or a mass exodus of population. Industrial development is hampered by the lack of any significant local entrepreneurial class.

The dryer West, on the other hand, has an extensive water containment system, and its farmers, because they have capital and relatively large tracts, are able to take advantage of new technology such as the "miracle" seeds...the West has a relatively large group of entrepreneurs with capital. In addition, the West has benefited from the massive Indus Water scheme, which has allowed the region to achieve self-sufficiency in foodgrains.

The East's share of total private investment has failed to increase because most investment opportunities are in West Pakistan and because Westerners are uncertain of the East's future. The outlook is for political discord between East and West to continue, however. There is even a possibility of an eventual break-up. Unable to improve much economically, the East will doubtless continue to blame its plight on domination by West Pakistani business interests whatever steps are taken by Western leaders to assist the East. If the East does gain control in Rawalpindi, increased resources may be diverted from the West in the hope of spurring development of the East. Such conditions could lead to efforts by West Pakistani leaders to regain control or to secede. Whoever precipitates any secessionist move, both sides would be hurt as the gains achieved through the free inter-regional flow of goods, services, and capital would largely be lost. The West, however, would soon recover, but the East would face an even slower growth rate than at present. 132/

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In this instance, the crystal ball of OER's area specialists proved quite reliable. The electoral victory that would have put an East Pakistani in the premiership was negated by the West Pakistani leadership. Secession did occur, and with Indian intervention, it succeeded. The economic plight of Bangladesh, successor to East Pakistan, was, of course, incomparably worse than that of the remaining west wing of the Pakistan republic. This judgment was reaffirmed in two intelligence memoranda prepared after the settlement with respect to the economic prospects of the two nations:

Bangladesh -- Economic prospects for Bangladesh are grim both for the immediate future and over the longer term.... Some parts of an infrastructure that was inadequate to begin with must be rebuilt. The probable return from India of millions of refugees will further strain supplies of food and other essentials...Long-term development faces severe handicaps. Natural resources are few and financial reserves non-existent. With most of the people already near the subsistence level, it is virtually impossible to invest a larger share of output. Little slackening in the rapid population growth can be expected for many years, barring famine. ...scarce technical and managerial skills have been lost during the months of fighting and incidental violence, and more will be lost with the departure of most remaining West Pakistanis.

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West Pakistan -- West Pakistan's long-term economic prospects are more favorable than those of India or Bangladesh. Loss of markets in East Pakistan and its net foreign exchange earnings will be less important than the fact that the West has been shorn of its poorest, most densely populated and economically stagnant region, which promised to be a growing claimant on foreign aid receipts and a declining net earner of foreign currency. West Pakistan is basically self-sufficient in foodgrain production, has a reasonably well-developed infrastructure, and is able to draw on a sophisticated entrepreneurial class. With its 6 percent growth rate in the 1960s, the West demonstrated that it could marshal its resources fairly effectively, with financial help from abroad.

The civil war in East Pakistan and the short conflict with India had relatively small economic effects in West Pakistan. Physical damage was slight except for India's bombing of the Karachi oil facilities and a few other industrial plants. The fighting did, however, contribute to uncertainty among investors. At the same time, Islamabad began to shift some of its interwing exports to foreign markets and secure its control over Pakistan's total foreign reserves. 133/

During the civil war itself (March-December 1971) and the brief Indo-Pakistan war which brought it to a climax, OER's reporting stressed the economic disruption that was created. 134/ Perhaps the worst economic consequence of the war was its devastating effect on the East Pakistan food situation, already in chronic deficit and not recovered from the severe floods and cyclone of late

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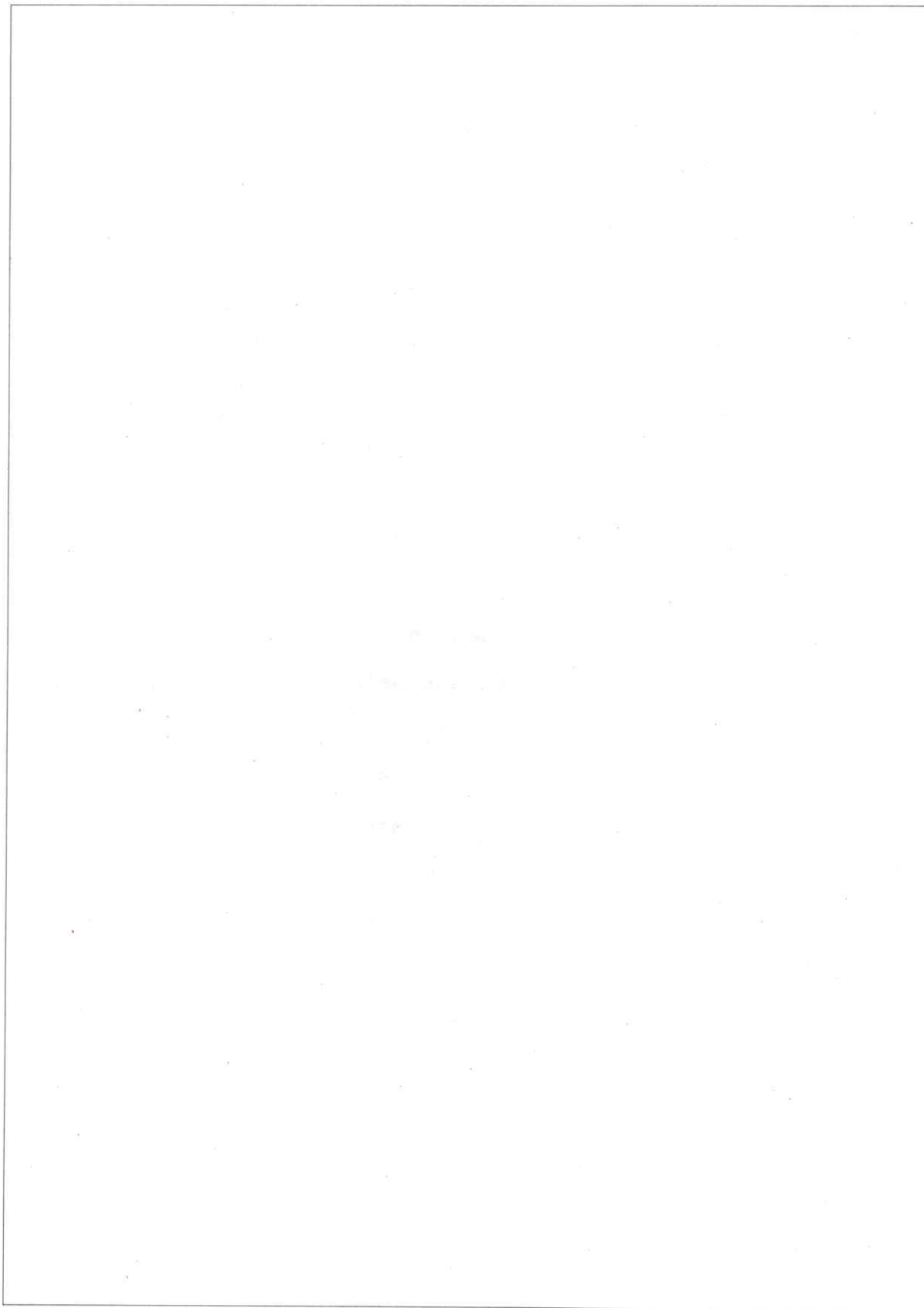
1970. 135/ OER's analysis of the East Pakistan food situation in the summer of 1971 predicted wide-spread hunger and the possibility of famine if the civil war continued. 136/ This was already a contributing factor in the massive refugee flow into India -- some 7 million by mid-July. This, in turn, was putting a severe burden on India, which was hard pressed to provide shelter, food, and medical care for the refugees. The impact on India was also the subject of an OER report in the summer of 1971. 137/ This report correctly forecast the Indian military intervention in East Pakistan as a result of economic, social, and political pressures from a continuation of the refugee flow at the rate then prevailing.

On the military side, the Office reported on the arms supply situation for both India and Pakistan, 138/ and after the hostilities started, on Pakistan's supply problems. 139/

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E. Model Building

Much of the research and analytical effort made by OER in the East Asian (non-Communist) world was aimed very directly at major US policy problem areas. Those included, of course, the whole Vietnam and contiguous Indochina arena**

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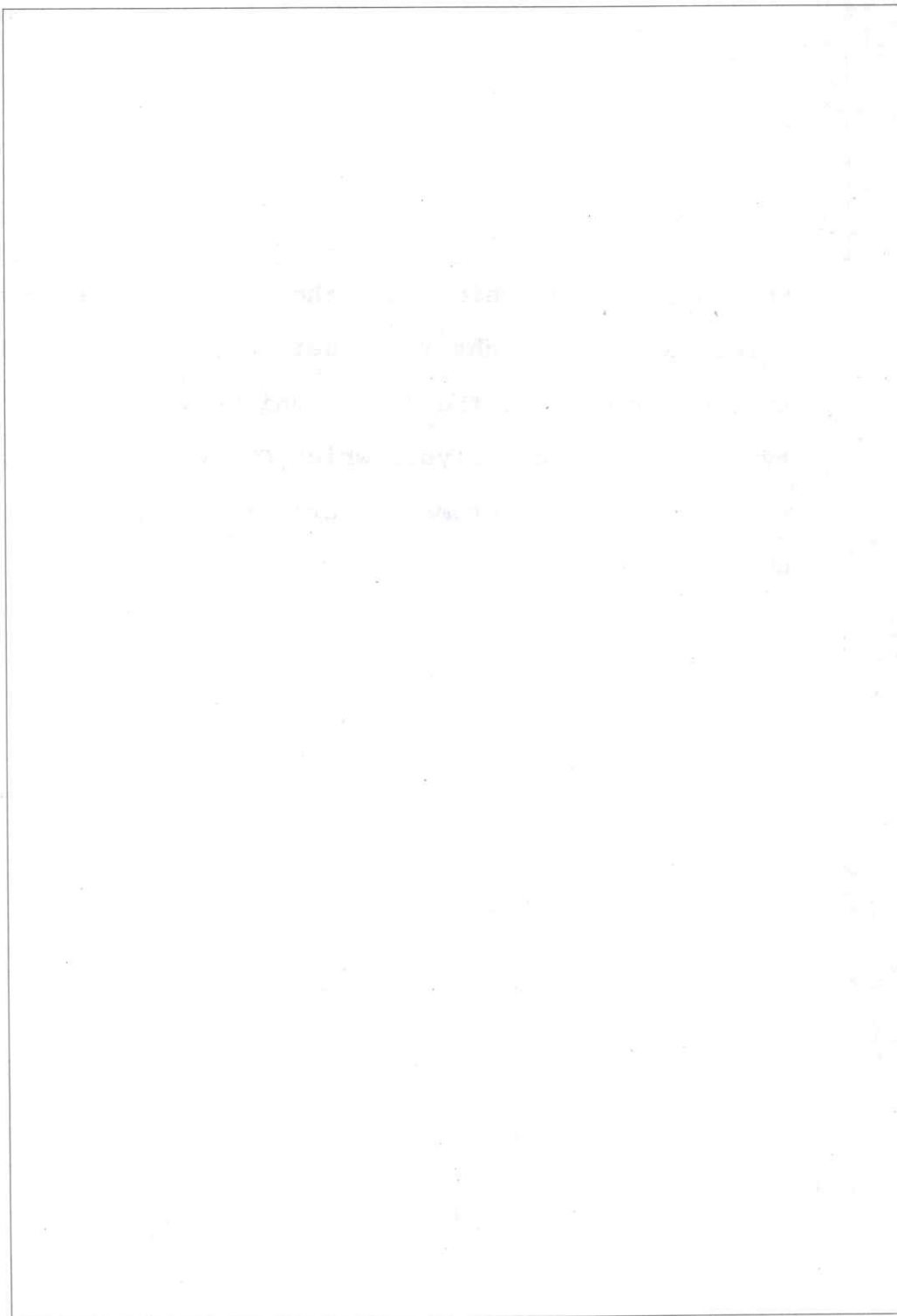
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For this reason, which gave the United States both a role and an insight into their economies, these two countries lent themselves uniquely to a new type of economic analysis which OER was beginning -- with the help of automatic data processing -- to undertake.

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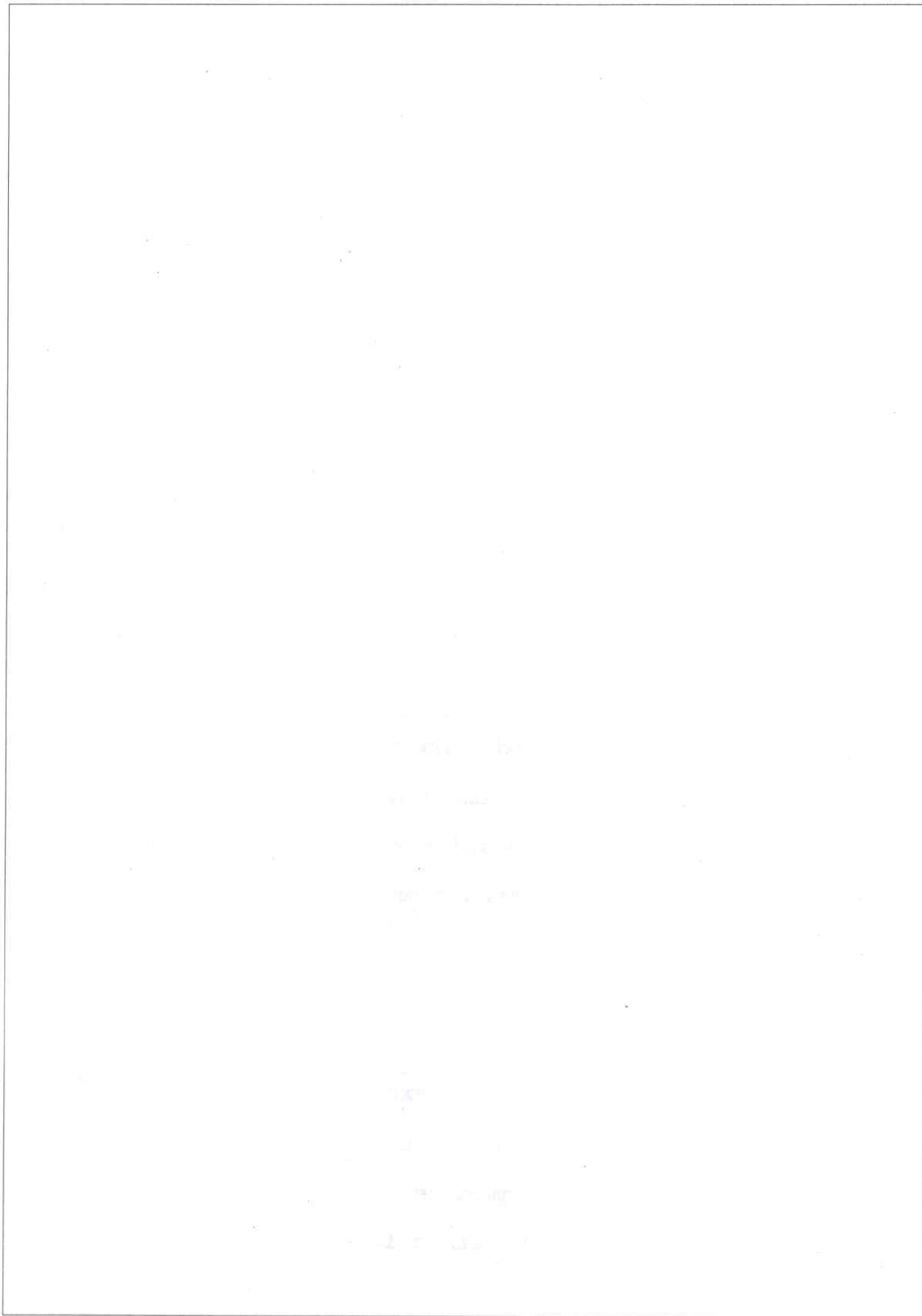
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OER's next published report on Taiwan, three months later, expressed optimism about Taiwan's continued rapid development despite the "moderately retarding effect" that increased commitments to defense might have. 143/

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expanding exports (then at and expected to continue at about 22% annually) could readily accommodate the planned expenditures for modernizing its armed forces, and if export

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growth declined, Taiwan could be expected to pursue "prudent and pragmatic economic policies which will assist in providing adequate funds to pay for the additional military outlays." 144/

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projections of Taiwan's trade outlook during 1970-73 "yield balance-of-payments surpluses under almost any likely circumstances." 145/

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(b)(3)F. Commodity Problems

OER's concern with the problems of the developing world took on new dimensions in the late 1960s when it became involved in policy support activities with respect to two commodity categories that are largely identified -- as to initial source -- with selected countries of the Third World. These are narcotics and petroleum.

1. Narcotics

The Office's first significant involvement in the Nixon Administration's program to curb traffic in narcotics was its participation in the Inter-agency Group established in the fall of 1969 to provide intelligence support to the White House Task Force on Heroin Suppression. The group was composed of representatives from the Bureau of Narcotics and Dangerous Drugs (BNDD) and from both DDP and DDI elements of the Agency. The Group's first substantive contribution was a study drafted by [] of OER addressed to the problem of suppressing opium production in Turkey, which

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was then estimated to be the source of about 80 percent of the US supply of illicit heroin. The study evaluated Turkey's role in the production of the world supply of opium and particularly its key role in supplying material for the consumption of heroin in drug-victim Western countries. It concluded that some forms of overt pre-emptive buying might be useful in suppressing opium production in the short run but that crop substitution in Turkey was the only long-term solution for the problems that suppression would generate for that country. The study further concluded that US aid would be crucial to the success of Turkish efforts in both suppression and crop substitution. 147/ Following this appraisal, the US government actively worked with the Turkish government in the development of programs to eliminate opium production in Turkey.

During the next two years, the government stepped up its concern with the international drug problem. This involved intelligence response on a wide front, and OER played a significant role in that response. [] was appointed alternate DDI coordinator for support to the White House Task Force on Narcotics in the fall of 1970 and the office published a number of reports dealing with the

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problem. One of these, The World Opium Situation was prepared on an unclassified basis for presentation to the Committee on the Challenges of Modern Society of the North Atlantic Council in Brussels. This was essentially a "primer" which attempted to estimate world production and consumption and describe the illicit trade patterns and wholesale organization. In addition, it traced the major post-war marketing changes and discussed problems involved in controlling illicit production, consumption, and trade in opium and its derivatives. 148/

Other reports dealt with regional or special aspects of the problem. For example, the particular problem of narcotics use among US servicemen in Vietnam was covered

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By the end of 1971, the narcotics problem was occupying the attention of the equivalent of

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full-time office positions [redacted]

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full-time to the Office of the DCI Coordinator on
Heroin Problems, the OER research effort, which
involved branches in both research areas, was placed
under the ad hoc direction of [redacted]
of the China Division. At least [redacted]

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[redacted] with regional responsibilities that
included a narcotics involvement was assigned to
the topic. [redacted]

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Much of the research effort by the Office in
this field resulted in publications which, together
with papers produced by OBGI on the subject, were
put out as Intelligence Memoranda in the Interna-
tional Narcotics Series. Some [redacted] OER papers had
been published in this series by the end of June
1972.

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An important summary of the Office's efforts in this field appeared when the 1970 paper on the world opium situation was up-dated and expanded in mid-1972.

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2. Petroleum

Drug abuse in the United States is, of course, primarily a domestic social problem and only peripherally an international economic problem. OER's ability to contribute in this area was the

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serendipitous result of its growing economic expertise on the countries that produce the primary product -- opium. Petroleum, on the other hand, had been a major concern of ORR from the inception of the Office in 1950 because of its strategic, military, and economic importance. The analysis of the Sino-Soviet petroleum position was a major preoccupation of ORR throughout the 1950s and 1960s. As work on the Free World developed, the Office expertise on petroleum matters became spread rather thin, and this created organizational problems.* By November 1970 the growing burden of analyzing of Free World petroleum production and distribution resulted in the creation of a Petroleum Branch in the International Services Division.

One of the first duties of this new branch was consideration of the developing crisis in the world oil situation as a result of new demands put forward by the Organization of Petroleum Countries (OPEC) at a meeting in December 1970. The OPEC, set up in 1960 by Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela, had by 1971 control of 70 percent of the world's proved crude oil reserves, 52 percent

* See the discussion of this problem in Chapter I.

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* See the discussion of this problem in Chapter I.

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of its production, and 90 percent of its international trade. 151/ With this kind of clout at their disposal, the oil producing countries were in a position to make severe demands on the international companies. For most of the OPEC's 10-year existence, differences between the moderate and radical members had weakened their bargaining power with the oil companies, but the December 1970 demands resulted from an agreement of all members. The demands were presented by representatives of the six Persian Gulf members to the oil companies in negotiations at Tehran in January 1971.

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OER's new Petroleum Branch, working with analysts from the Near East Branch and other branches, reviewed the background of events leading up to the crisis, and attempted to forecast the results of the bargaining sessions and the impact of higher prices. The tentative conclusion, while the negotiations were still in progress, was that about \$0.40 per barrel increase in cost would result, boosting OPEC government revenues by 30 percent, but that the impact would be easily absorbed by the major oil

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consuming countries of Western Europe and Japan in the short run, i.e., there would be a 1 percent rise in consumer prices for petroleum products in 1971. 152/

The Office attempted also in its responses to lay to rest the bugaboo of Soviet machinations in the situation

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This subject had cropped up before on a number of occasions.

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However, the Office's petroleum specialists had, at that time, maintained that the Soviet share of Free World markets -- about 5 percent -- would not change significantly. 155/ This judgment had to be repeated on several occasions because the oil companies continued to be nervous about it and about the possibility of the Soviet gaining control of Middle East oil and had

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pressed their views on policy officials. Thus

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expressed

the view that Soviet meddling in the Middle East was motivated by an interest in controlling petroleum suppliers there. OER's response indicated that the USSR had no strategic requirement for Middle East oil and still presented no threat to the entrenched position of Free World oil companies in their principal markets. 156/ The Soviet oil position also engaged the attention of Henry Kissinger during the following year. In response to a request from his staff in September 1968, OER noted that Soviet exports of petroleum to the Free World still amounted to only about 5 percent of Free World demand (excluding the United States). Even this small percentage constituted the largest single source of foreign exchange for the USSR.

The response concluded that:

The USSR has sufficient oil production and resources to meet its domestic demand, to supply most of the oil needs of other Communist countries, and to continue exports to markets in the Free World for the foreseeable future. Efforts to secure oil from Free World sources, primarily the Middle East, in exchange for industrial goods and services appear to be designed to release corresponding quantities of Soviet oil for export to hard currency

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markets in the Free World. The quantities likely to become available to the Communist countries through these barter deals are expected to be small and should have a minimal effect on world oil trade patterns. 157/

By mid-1971, the major concern of US policy-makers had shifted to the implications of the growing financial power that Middle East oil producers were acquiring through their burgeoning oil revenues. The estimate at that time was that the collective gold and foreign exchange reserve of the Persian Gulf and Mediterranean oil producers could easily exceed \$25 billion by 1975 -- a situation that OER characterized as "both a commercial opportunity and a political challenge to the United States."* 158/

The commercial opportunity, in the short run, was not particularly promising. US exports to the area already greatly exceeded US purchases from there. Some of the potential market was limited

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by the small populations and limited development programs of the smaller states (Kuwait, Abu Dhabi, and Qatar) or the political restraints imposed by anti-American regimes (Libya and Iraq). The best -- actual and potential -- customers for the United States in the region were Iran, which was carefully shopping for bargains in both Communist and West European markets, and Saudi Arabia, which traditionally pursued conservative financial policies. Within these limitations, however, the report acknowledged the long-run potential for a sizable percentage increase in US exports, particularly of capital goods associated with the oil and petrochemical industries or with general economic development programs.

The political dangers in the situation created by huge accumulations of foreign exchange were identified by OER as: (a) the threat of nationalization: even if fully compensated, a significant balance-of-payments loss would result from the loss of profit repatriation; (b) subsidization of radical political movements; and (c) financial manipulation in foreign exchange markets. 159/

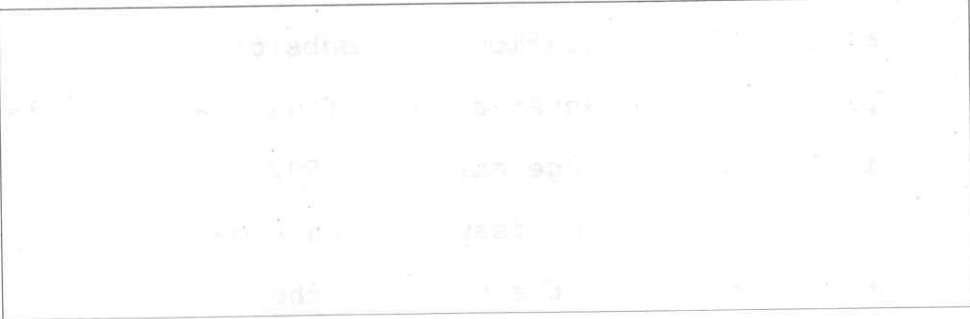
The next major issues which came up for negotiations between the OPEC and the international

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oil companies were the efforts of the member countries to participate in the management of the companies and to seek increased revenue to offset the losses in purchasing power after the effective dollar devaluations in 1971. These issues came up for negotiation at OPEC meetings with the companies in January 1972. The implications and likely outcome of the meetings were discussed by OER in two intelligence memoranda in that month. The participation issue was expected to be a long drawn out affair, but it appeared inevitable that the oil companies would be forced to agree to some degree of participation. 160/ The adjustment in prices was negotiated relatively quickly following the Smithsonian Agreements of 18 December 1971. Provisions were made in the January meetings at Geneva for 8.49 percent increase in the prices of Persian Gulf exports with future quarterly adjustments based on a foreign exchange parity index of nine major currencies relative to the US dollar. 161/



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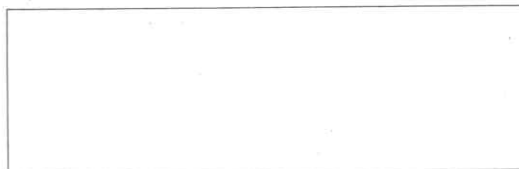
Although preoccupied during much of its brief history with the complexities of the relationship between OPEC and the oil companies, the Petroleum Branch also provided significant policy support in 1971-72 on petroleum availabilities to the contending sides in the Indo-Pakistan war, on the effects of bombing on petroleum supplies in North Vietnam, and other items of current interest.

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Chapter VI

THE US ECONOMY AT BAY



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~~SECRET~~A. Introduction

In the summer of 1971, [] was asked by a senior member of the Board of National Estimates to comment on a phrase the latter had written for inclusion in a DCI speech to the effect that the United States is []

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[] response was illustrative not only of the didactic role being assumed by OER but of the true stature of the US economy in the early 1970's:

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By the time of this exchange, the deteriorating international competitive position of the US economy was in the forefront of policy concern, as highlighted by President Nixon's New Economic Policy announced only two weeks before. OER's involvement with US economic problems antedated these events, however, by several years. As recounted in Chapter II, the work done by OER on international

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monetary affairs, which started with coverage of
the sterling crisis of late 1967

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The growing pressures on the dollar were, of course, manifestations of broader economic developments which had led to the decline of the United States from its position of dominance on the international economic scene. Although other departments of government were analyzing the causes of this decline, they were also those responsible for dealing with it. For this reason, policy papers dealing with this problem tended to be "essentially inter-departmental compromises of various parochial views." 165/

OER, as an organ of a non-policy agency, was in a good position to fill the need for the

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production of objective intelligence studies. As

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[] put it:

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In proposing a reorganization of effort to bring more analytical strength to bear on key problem areas, [] pointed out, with respect to Western Europe, that OER had the only unit in Washington with the capability of doing full-time, objective, all-source research on the area.

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These considerations led to a number of organizational shifts in 1970 to handle OER's responsibility for support of US economic policy in these areas. The Western Europe Branch was abolished, and two new branches created -- a European Community Branch and an Atlantic/Mediterranean Branch. The former was to handle economic coverage of European Community countries

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policies, and institutions. [REDACTED]

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Far East Branch and a South Asia Branch established.

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[REDACTED] A Petroleum Branch was

established (November 1970) to handle all Free World petroleum matters, focussing on the Middle East.

The Office had, of course, been maintaining a capability to analyze the internal economies -- and to a degree the international economics relations [REDACTED] since it "went global" in the mid-1960's. This capability had enabled it to meet its commitments to the NIS program, to contribute to NIE's as called for, and to

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respond to other needs of the community with emphasis on the security implications of these countries' economic performance and capabilities -- that is, the economic foundation of their military power and consideration of their economic relations with the Communist World, as clues to how they might "tilt" in an East-West confrontation.

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These wider substantive responsibilities were accompanied by the broadening of OER's list of regular consumers.

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These briefings not only added to the Office customer roster but also led to new requirements for support by the

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stimulation of requests for specific studies --
for example, on East-West cooperative ventures
and prospects for US trade with Eastern Europe.

B. Council on International Economic Policy (CIEP)

An even more significant boost to OER's support
role occurred early in 1971, when President Nixon
established the Council on International Economic
Policy to ensure top level focus on international
economic policy issues. Chaired by the President,
the Council was composed of the Secretaries of State,
Treasury, Agriculture, Commerce, and Labor, the
Chairman of the Council of Economic Advisers, the
Director of the Office of Management and Budget,
and other key administration officials. OER thus
found itself with a new White House consumer with
a stature on a level -- on paper at least -- with
the National Security Council, which had in its
own right been making significant demands on the
office for policy support. The Council's Executive
Director was Peter G. Peterson, Assistant to the
President for International Economic Affairs.

Immediately after the Council's formal estab-
lishment on 19 February 1971, [] talked with
a number of "non-State" policy officials in order
to determine what OER's role might be in the

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service of the new Council.* His initial recommendation following these discussions was [redacted]

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[redacted] In addition, he sent Peterson a personal copy of the US-Japan economic relations briefing book being prepared on a crash basis for the Department of Commerce. His covering letter advised Peterson that "...we are the research backbone of economic intelligence production in the US Government" and offered to discuss how the Office could assist Peterson. 171/

No formal response to this offer has been found, but it was evidently received with favor. A major element in [redacted] plan was accomplished

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* Those contacted by [redacted] included Dr. James Schlesinger, then Assistant Director of the Office of Management and Budget; Ambassador Carl J. Gilbert, the President's Special Representative for Trade Negotiations; Harold Scott, Director, Office of International Commerce, Department of Commerce; and Mr. Anthony Jurich, Special Assistant for National Security Affairs, Department of the Treasury. [redacted] reported "I have a feeling that Mr. Peterson will be told [by Scott and Schlesinger] that one of his problems is to provide a means for CIA economic research material to be fed in at a level where it will be most effective. 169/

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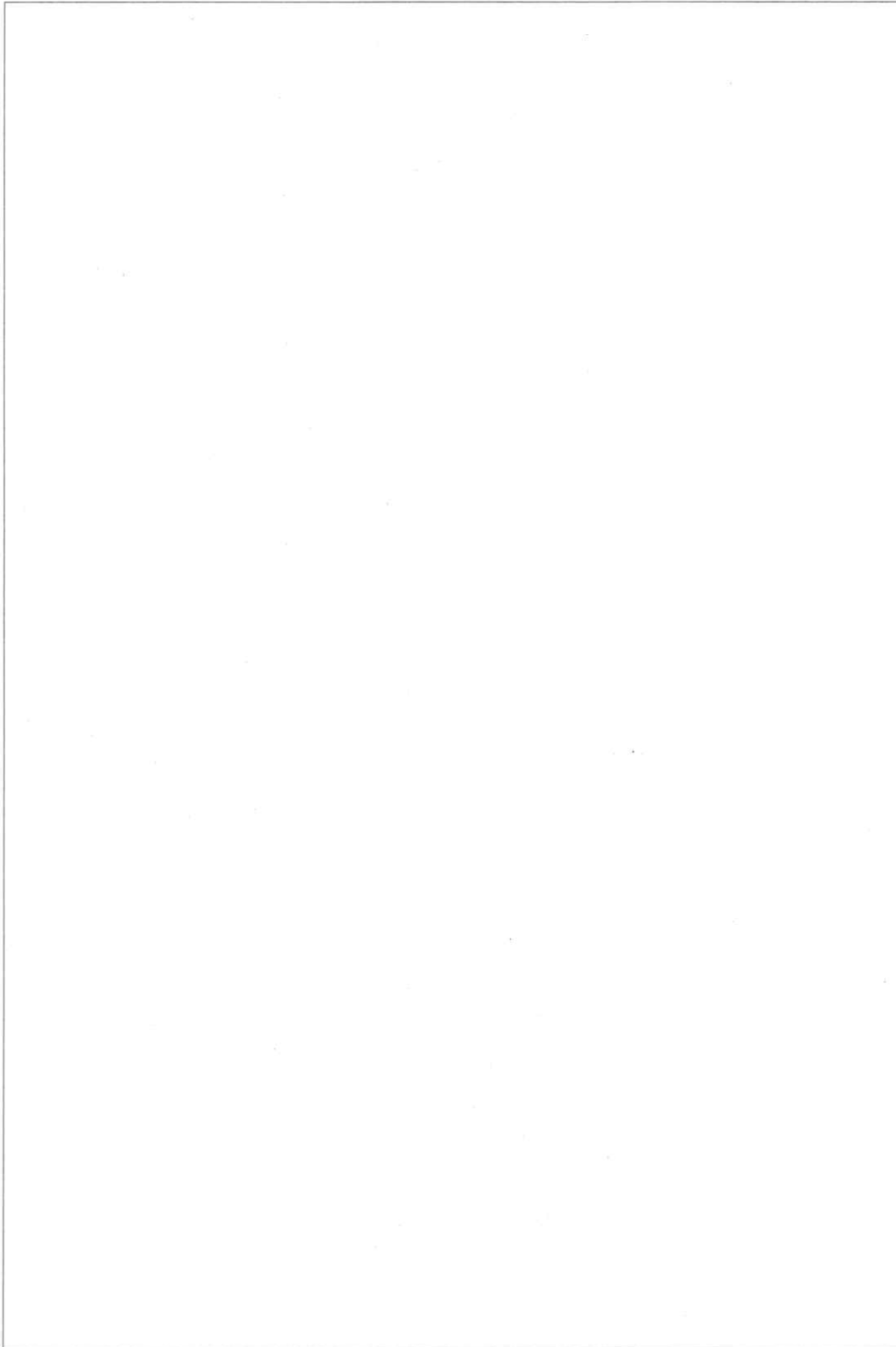
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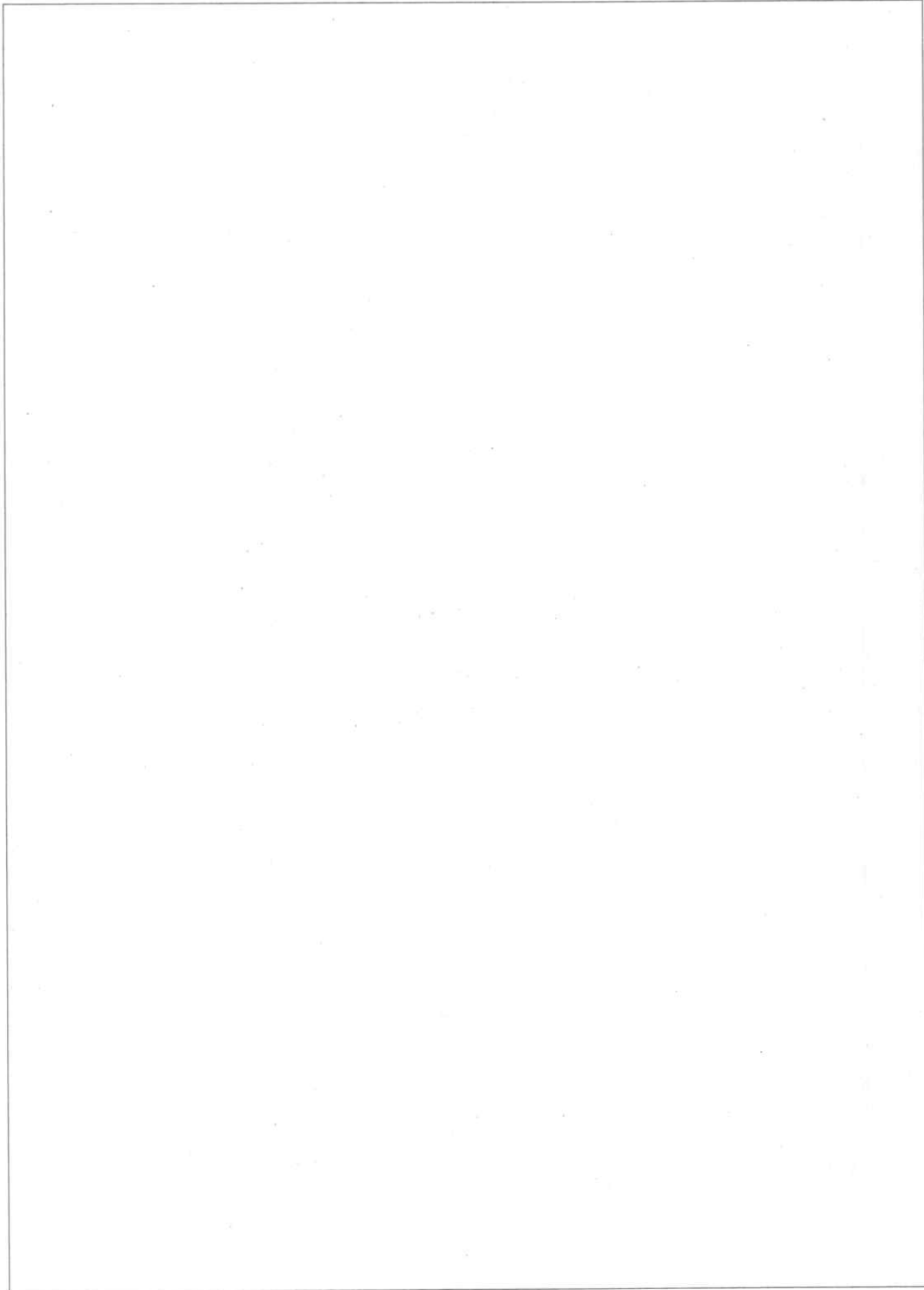
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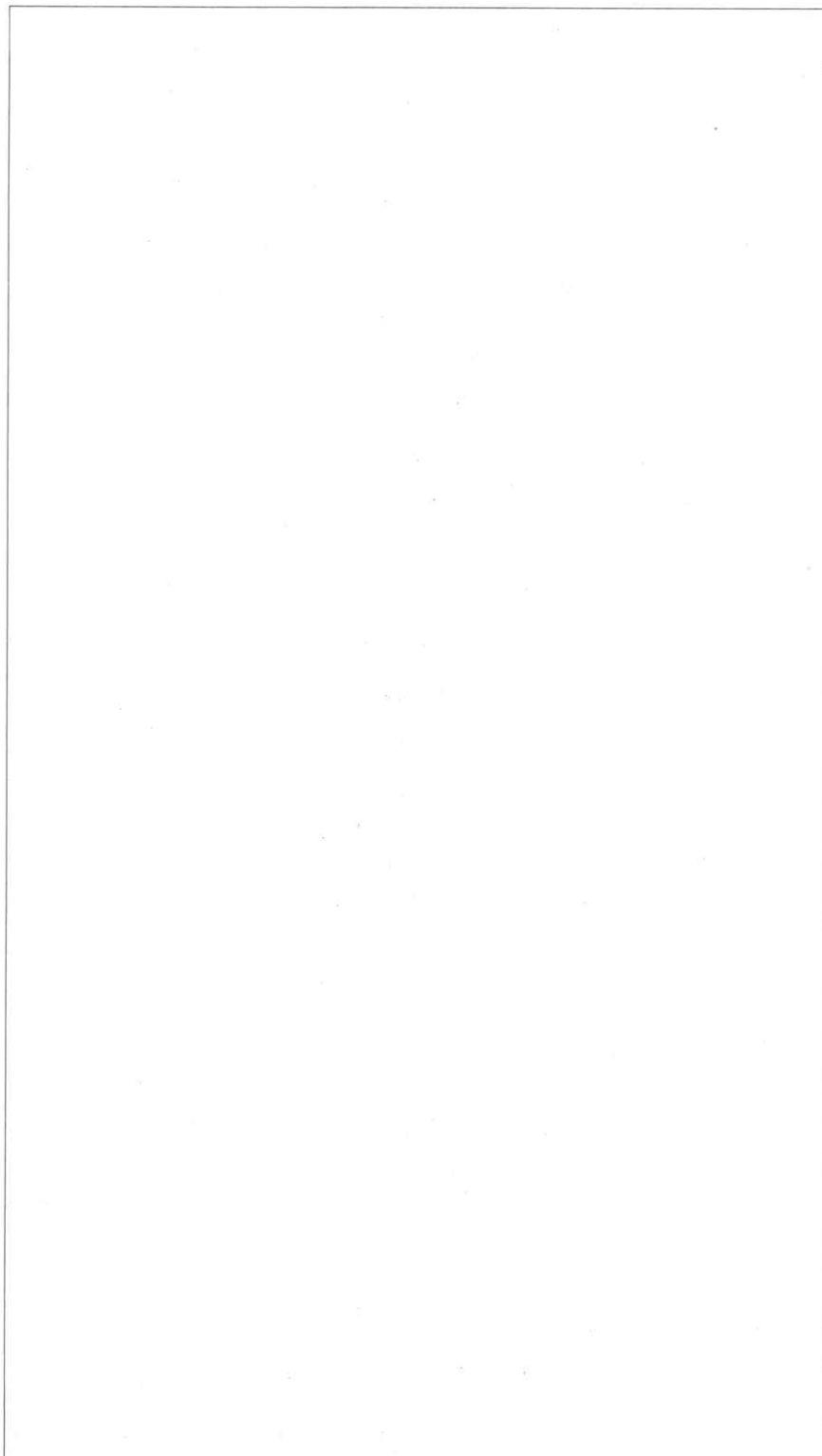
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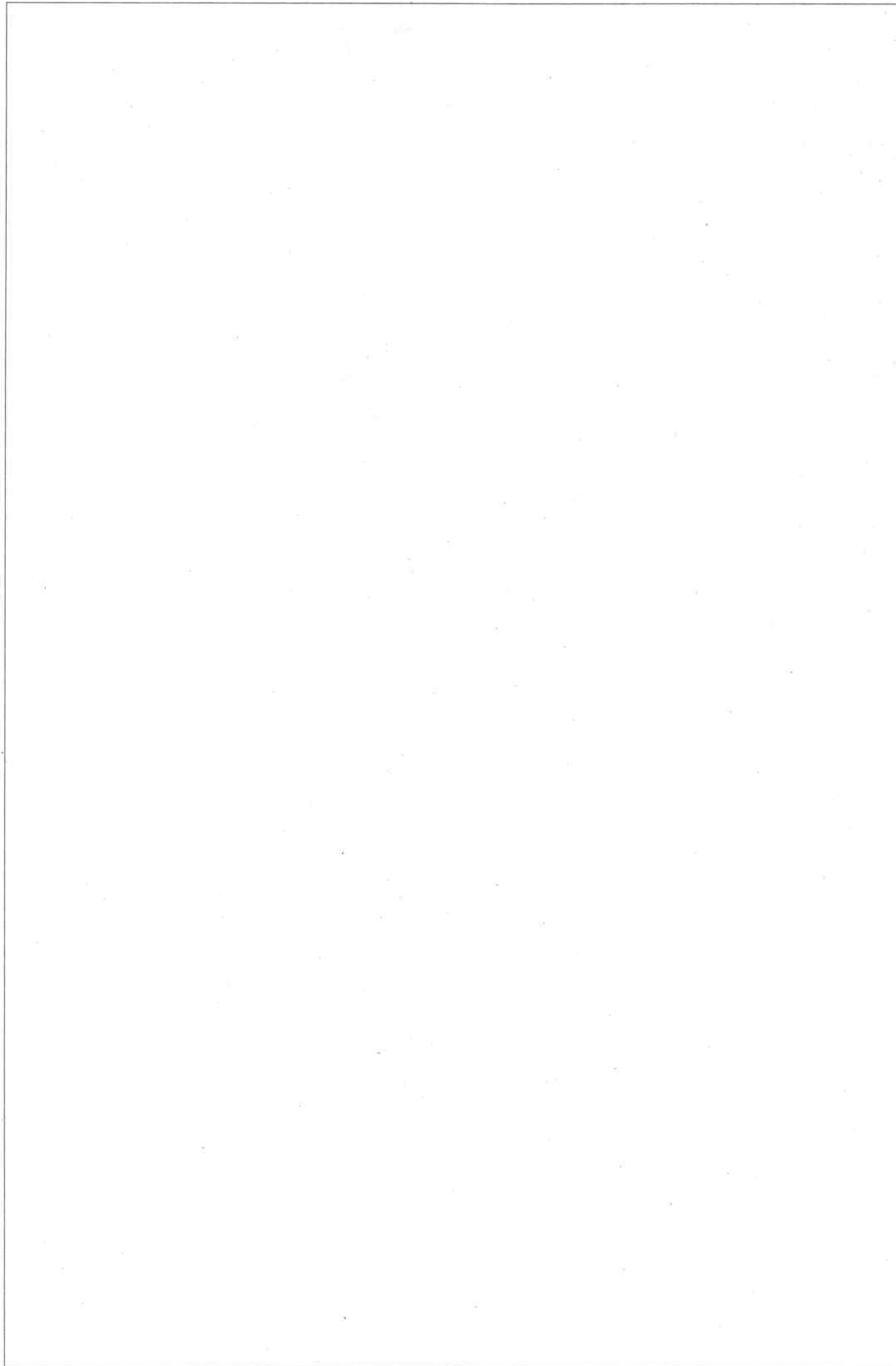
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2. A review of East-West trade, particularly US trade policy toward the East European Communist countries, including the USSR. OER participated, in this case, as a member of an inter-departmental working group, under the chairmanship of the Department of Commerce.** It was largely responsible for making projections for the 1970s of likely levels of trade under a variety of possible degrees of control as might be laid on under US economic defense policy.

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** The Chairman was Sherman R. Abrahamson, Deputy Director, Office of Export Control, Department of Commerce

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OER and its predecessor, ORR, had devoted considerable attention to East-West trade in the past* and had rarely been bullish about its potential, particularly where the United States was concerned. In commenting on Department of Commerce projections of US trade with the Communist countries for an earlier policy study (NSSM 35), OER estimated that such trade would remain insignificant through 1975 -- perhaps \$600 million (exports plus imports) -- only about 5 percent of total East-West trade, which would grow more slowly than it had in the 1960s. It cited both economic (chronic shortages of hard currencies and heavy indebtedness to the West) and political (Soviet-inspired "economic rapprochement" in CEMA) reasons for this pessimism. 185/ In spite of the well-documented grounds for pessimism about East-West trade, it continued to be a popular cause in 1972, as the United States actively sought trade opportunities under the spur of its balance-of-payments difficulties. Thus in March 1972, we find such outside comments as the following:

* See, for example, ORR's activities in support of President Johnson's bridge-building overtures, Volume II.

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The United States alone among the developed countries has purposely chosen not to develop a meaningful economic relationship with Eastern Europe... Belatedly, the United States is now beginning to recognize the long-term trade potential of this area. 186/

3. OER's first comprehensive economic analysis of United States-Canadian relations was also carried out at the behest of the CIEP. Following a request from Peterson to Helms, OER produced on a crash basis a study, similar in scope to -- and suggested by -- [REDACTED] which analyzed in detail Canada's changing economic relations with the United States.* The basic analytical memorandum was supported by eleven appendixes covering not only the basic productive sectors of Canada's economy but also US investment in Canada, Canada's financial markets, [REDACTED]

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[REDACTED] The report noted that the US trade surplus with Canada, which was sustained for more than three-quarters of a century, had dramatically turned in 1968 and by 1970 had become the United

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States' largest trade deficit -- almost \$1.4 billion. The basic balance was likely to remain in deficit, although a US surplus on services was expected to result in a surplus balance on current account. In the meantime the benefit that both sides continued to receive from their close bilateral economic relations was expected to override the many chronic and potential new friction points in the relationship. 188/

C. The Briefing Books

Both OER and its predecessor have over the course of their history given sporadic ad hoc support to a wide range of non-USIB agencies -- not only the Cabinet-level departments, but also the Council of Economic Advisers, the Office of Management and Budget (formerly the Bureau of the Budget), the Office of Emergency Preparedness, the Federal Reserve System, NASA, ACDA, the AEC, FAA, the Export-Import Bank, and, of course, the Congress.

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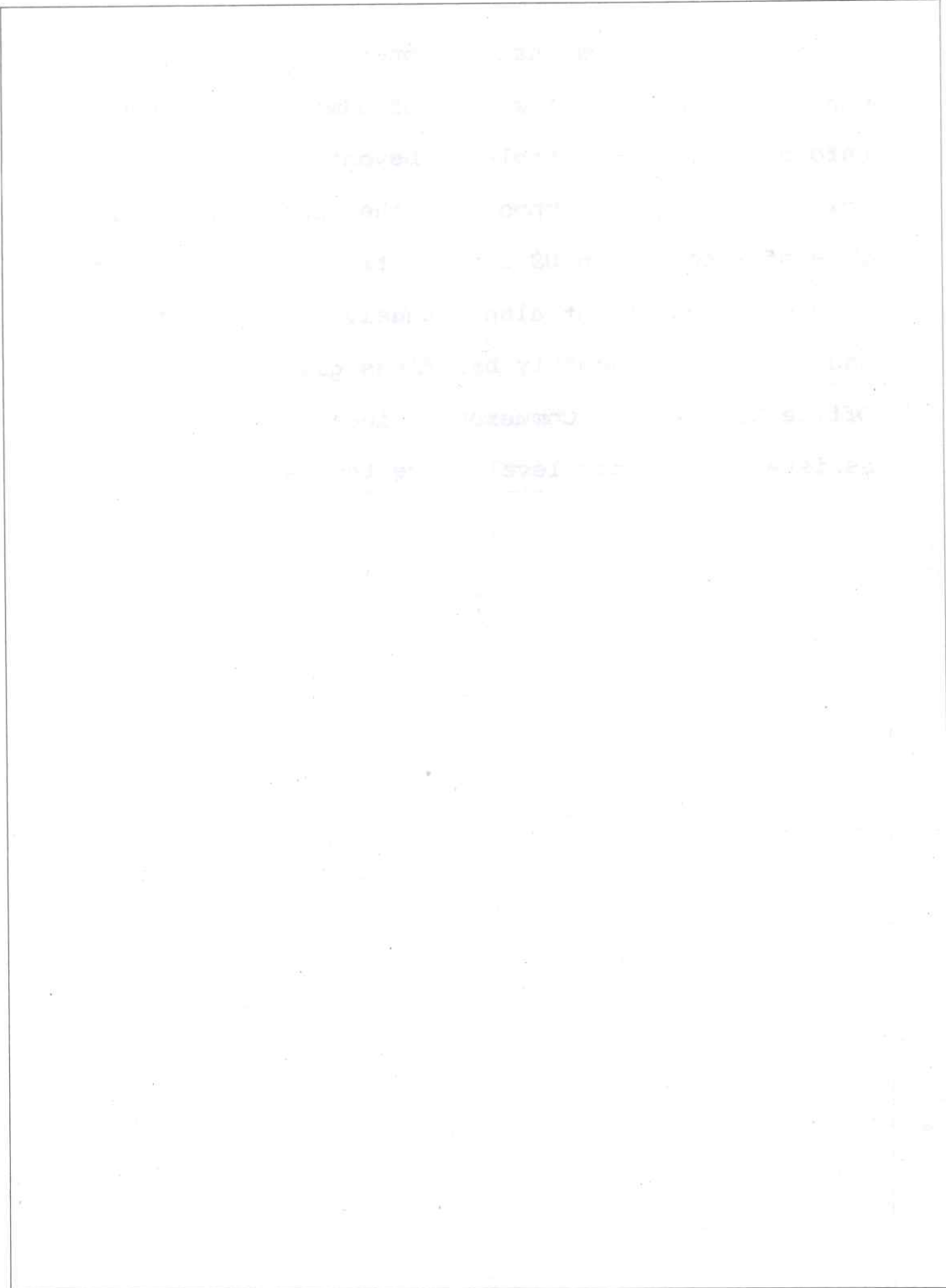
The Office's extensive support to the Department of Commerce in its role of administering and enforcing export controls is beyond the scope of this history. Its support to the Department in its role of encouraging US foreign trade in the 1970's is a more recent but also extensive effort. In addition to the monthly briefings given by the Office Director to Commerce offices at the deputy assistant secretary level since the fall of 1970,

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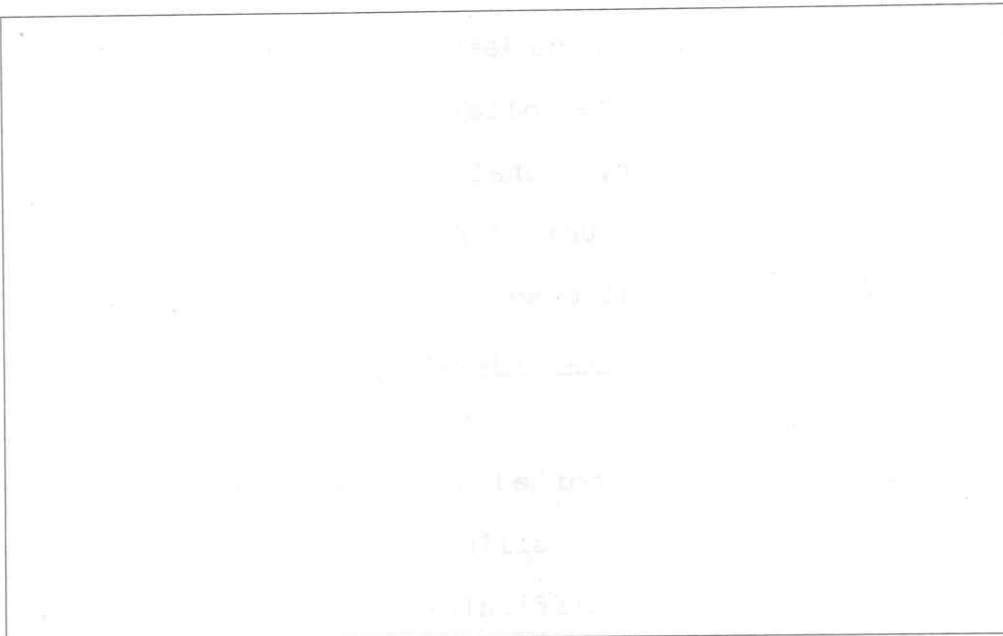
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D. Nixon's New Economic Policy

The major substantive preoccupation of the Office in the late summer and fall of 1971 was the global impact of President Nixon's new economic policy announced on 15 August 1971. The Office had been closely watching and reporting on the problems of the dollar since late 1967.* The most recent of its publications on the subject, prior to 15 August, were Nos. 27 and 28 in the International Financial Series. The first of these, The Revolt Against the Dollar, was an analysis of a major monetary upheaval that had reached a climax in May 1971 when a number of European central banks,

* See Chapter II.

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led by West German's Bundesbank, had ceased fixed-rate purchases of the dollar and allowed their currencies to float, signaling the end of the dollar's -- and the United States' -- dominance of the international monetary system. 190/ The second, entitled Recent International Monetary Trends, was issued four days before the Presidential announcement. It reported a wide-spread European concern about the disequilibrium in the US balance of payments and the difficulties in the US domestic economy. It forecast "continued talk of dollar devaluation, gyrations in the price of gold, and speculative runs into one currency or another." 191/

On 15 August the President announced his new economic policy, of which the significant international points were a suspension of the convertibility of the dollar and the imposition of a 10 percent surcharge on imports. OER's initial publication following this announcement was an intelligence memorandum in the International Finance Series (No. 29) written for elite dissemination by

[redacted] on a crash basis [redacted]

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[redacted] The foreign reaction, initially one of

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shock, was expected to be one of continued uncertainty and caution. The major nations were in varying degrees accepting greater flexibility in exchange rates, i.e., a float against the dollar. This flexibility was expected to continue for several months. In the longer term, the paper predicted that, although universal adoption of flexible exchange rates was possible, the more likely course was:

...a return to a new set of parities, probably with exchange rates allowed to fluctuate within wider bands than before and perhaps with some provision or understanding to facilitate adjustment of parities in the longer term.

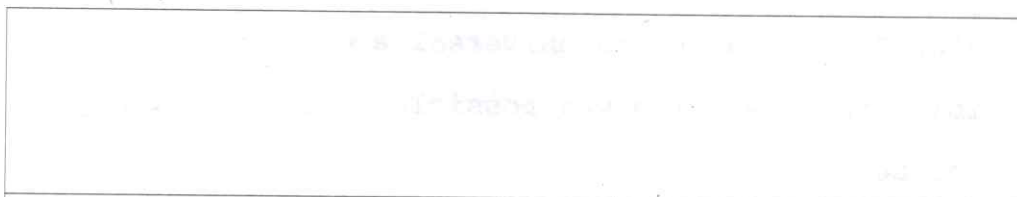
Arriving at an agreement on new parities, however, will not be easy. The US Government wants a sufficient devaluation of the dollar to eliminate the chronic US balance-of-payments deficit. Foreign governments would prefer a smaller devaluation. There are wide disagreements about the role of gold and the dollar in the international monetary system and on the type and use of any new international currency that may be formed.

The critical element in the determination of new exchange rates and new uses of international liquidity may well be the nature of any agreement among EC members. If the EC countries agree to new exchange rates among themselves that involve a substantial average devaluation of the dollar, there should be few obstacles to agreement on a global scale, and Japan would find accommodation relatively easy. But if the EC countries agree to exchange rates

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involving only a small average dollar devaluation, or none at all, an impasse may result. It is possible that the Europeans would then move to link their currencies to gold or some new EC unit of account and to establish tight controls over dollar transactions, at least on capital account. To balance its payments, the United States would have to bargain bilaterally with the Europeans as a group and with the Japanese and the Canadians. 192/

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Since ONE considered an NIE to be an inappropriate vehicle for this topic, ONE and OER decided instead on a joint project -- with a contribution from OCI. This appeared in November 1971 and was a much more elaborate analysis than had been possible on a crash basis in August. In essence, however, its message was similar. It noted that there was need for an agreement on new parities but stressed the difficulties in the way of such agreement and noted the atmosphere of general economic uncertainty which was slowing investment and trade throughout the industrialized world. The paper included a detailed appendix, noting the individual reactions of the major trading nations and of the European Community as a whole. The impact on and the reaction of the

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less developed countries was also discussed. 193/
The omission of any significant mention of the Communist countries in this context,* is a silent but eloquent commentary on the minor role played by the Communist world in the international economic arena.

E. The Smithsonian Agreement

During the four-month period following the announcement of the US New Economic Policy in August 1971, a number of meetings of the ten leading industrial nations were held, culminating with the Smithsonian Agreement in December. OER made a significant contribution to the US capability to negotiate in these meetings. This was the development of a trade-flow model which provided a means of predicting the effect of exchange rate changes on the pattern of trade balances. 195/ Although the formulation depended heavily on a number of assumptions about the parameters (in economists' jargon -- the elasticities of demand, supply, and

* The Communist countries were mentioned only with regard to their inadequacy as trade and aid alternatives for the Third World, which found only 5 percent of its exports and an even smaller proportion of global aid flows accounted for by the Communist nations. 194/

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substitution) which were chosen to measure the strength of causal changes, and it was necessary to publish the model with many caveats about its predictive accuracy, the model was used with some effectiveness for this purpose.*

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Other support activities relating to the international monetary crisis in the fall of 1971 may be summarized briefly. They included:

- a. An analysis of Japan's Eight Point Economic Program for the guidance of US officials meeting with Japanese cabinet officers in September. 197/

* The model was developed from one in use by the International Monetary Fund, but the assumptions which were fed in were made by OER. Requests for applications of the model were frequent -- and during the negotiations, urgent. With on-line computer access, the office was able to respond to these urgent requests within fifteen minutes.

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b. A separate assessment of the impact of the new economic policy on the less developed countries. 198/

The meetings of the Group of Ten financial powers culminated on 18 December 1971 with an agreement ending the four-month period of floating exchange rates and general monetary uncertainty. The so-called Smithsonian Agreement resulted in a 7.9 percent devaluation of the dollar relative to gold -- nearly 10 percent relative to a weighted average of the currencies of the significant US trading partners. Using OER's modification of the IMF trade flow model, the devaluation was calculated by the office to point to an improvement in the US trade account by about \$8 billion annually. 199/ The cited report analyzed the impact of the agreement on the major trading partners of the United States as well as on the developing countries. The Communist world was dismissed with the curt observation that

...there will be no direct economic impact on the Communist countries. The USSR is maintaining the gold content of the ruble, which, in effect, upvalues it in terms of the dollar, but this is essentially a book-keeping convenience. 200/

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During the following six months, i.e., the balance of the period covered by this history, OER continued its analysis of the international monetary scene in a variety of ways. Most of this work was done in the Free World Division with the close cooperation of the Systems Development Staff, which worked together with the Atlantic/Mediterranean Branch on further refinement of the trade-flow model. The refined model more explicitly reflected the time lags in trade balance adjustment. (The previous paper had warned that such time lags would slow improvements in the US trade balance. 201/) It also made allowances for the impact of international differences in rates of economic growth. Again it warned against using the model for estimating purposes. Because a number of factors bearing on international trade, e.g., international differences in rates of inflation, continuing trade restrictions, and the like, were not reflected, the model could at best indicate general orders of magnitude. With this caveat, the report forecast a slow but substantial improvement in the US trade account. Over a three-year period, the swing in the US trade balance would be about \$5.6 billion at an annual rate. 202/

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~~SECRET~~F. Expropriations of US Properties Abroad

The policy problems created by expropriations of US private investments in developing countries were not found solely in the Latin American context. There was in the 1967-72 period a spate of takeovers, added restrictions and controls, and other symptoms of decreasing hospitality to US direct investment throughout the less developed world. These actions and their implications for US policy stimulated a CIEP request for an analysis of the international investment picture in the fall of 1971. OER's response was an intelligence memorandum attempting to give some statistical measure of US direct investment abroad, including its geographic and industrial distribution and the relative rates of return. It also assessed the economic impact on the LDCs and the gains and losses accruing from US investments. 203/

US investment in the LDCs was found to be (in book value, which usually considerably understates current value) about \$21.4 billion, slightly more than 27 percent of an overall US direct investment abroad of some \$78 billion. Most -- though a decreasing share -- of US holdings in the LDCs were

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in extractive industries, a fact that creates its own set of policy problems because of the growing US dependence on foreign sources of raw material supplies, particularly petroleum. Summing up the investment climate in the LDCs as of late 1971, the report noted:

Over the last decade or so, the climate for US direct investment in the LDCs has become less hospitable, and in some areas -- particularly in Latin America -- this trend has intensified in the last couple of years. In numerous instances, the properties of US firms have been expropriated, sometimes without compensation. In August 1971, for example, 45 expropriation cases and 26 negotiated purchases of US properties were pending in the LDCs. The widespread increase in restrictions and controls on foreign firms is perhaps even more indicative of the changing climate for foreign investment in the LDCs. In general, these controls seek to maximize benefits from foreign capital, management skills, and technology while limiting foreign profits, control, and sectors of operation. 204/

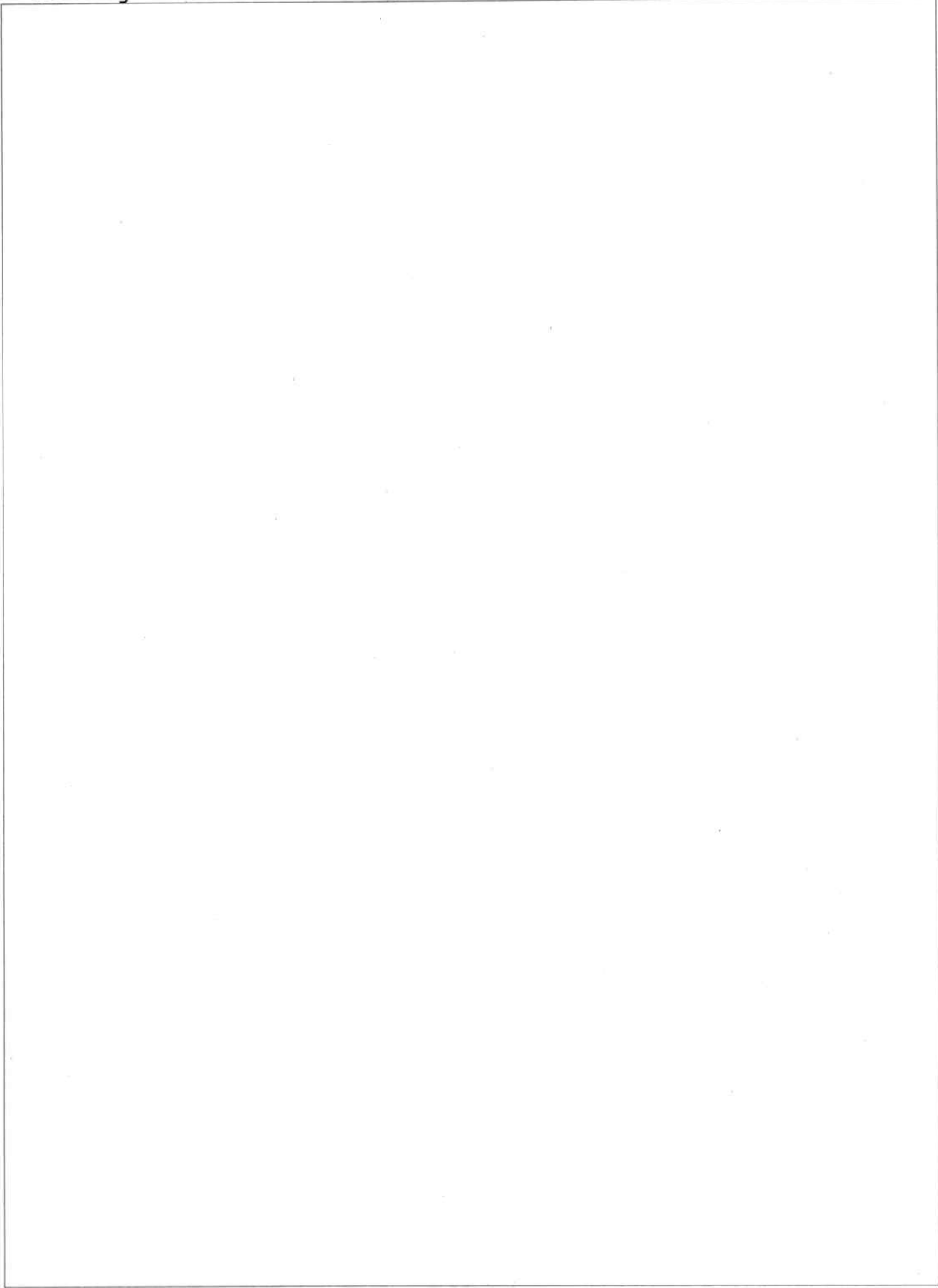
The report forecast, however, that such investment would probably continue to grow because of US dependence on raw materials and because of continuing profit opportunities but that some of the investment capital would be shifted to lower risk countries and that there would be a greater effort to participate in joint ventures with local capital and -- even more likely -- to form consortia with

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West European and Japanese investors -- "thereby
internationalizing exposure to punitive action by
host governments." 205/

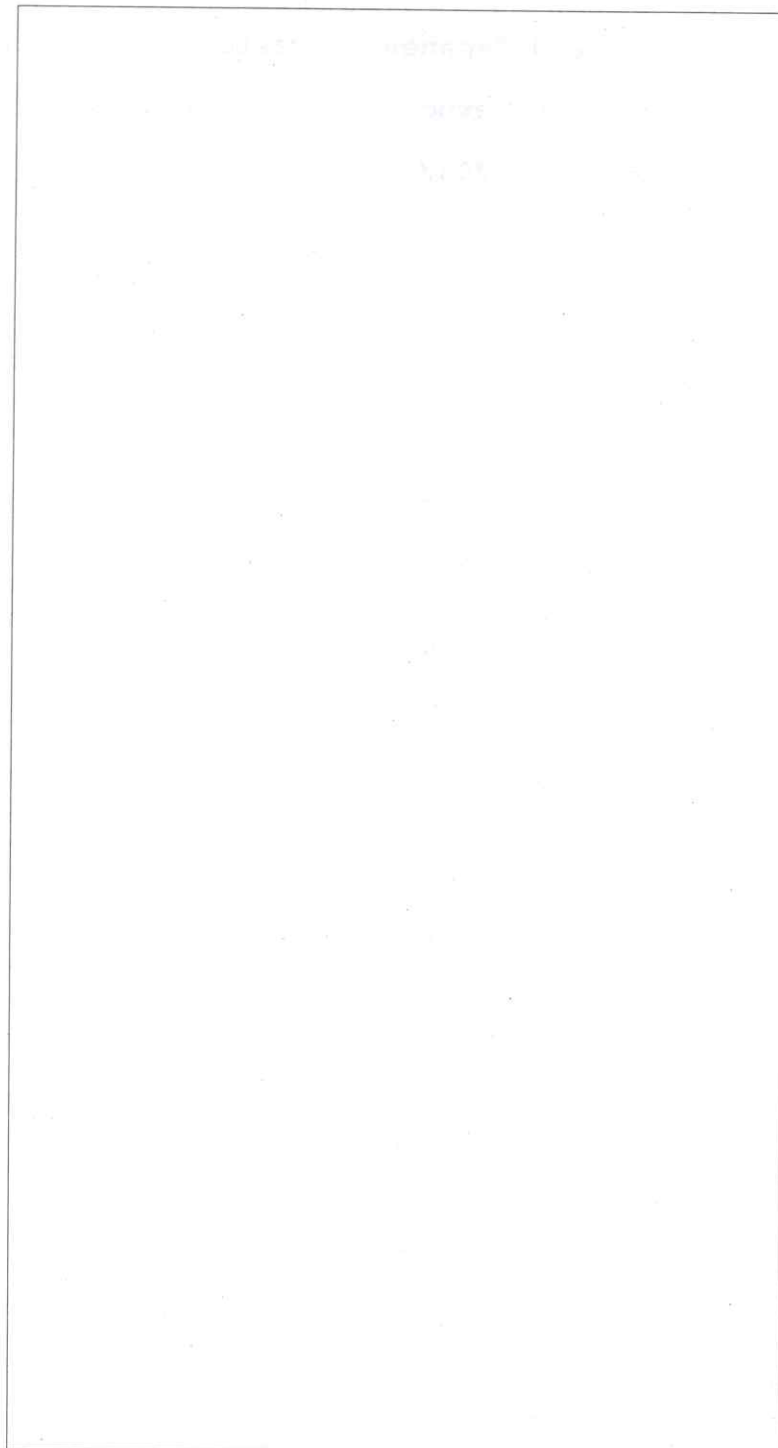


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A somewhat related matter came up earlier in the year with respect to the application of the so-called Symington and Conte-Long legislative provisions which restrict US arms sales and economic aid to those countries who are adjudged to be spending for defense -- particularly for sophisticated weapons -- on a scale that appears to interfere with economic development. As a result of this policy, a number of Latin American countries found themselves unable to obtain the modern weapons they wanted from the United States and had turned to other Western supplies. The regional, economic, and strategic impact of these purchases was analyzed by OER, 207/ and the results of the analysis were summarized by in a letter to Peterson, suggesting that this problem be added to his list of things to think about with respect to US export policy. His major points were that more than Latin America was involved, that these countries could easily turn to other suppliers, and in the case of Iran, for example, this meant the Soviet Union. He further suggested that:

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The basic question is whether the self-imposed restrictions, which will deny the US substantial quantities of foreign exchange, are really justified. The question

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is more relevant than before since the oil producing Arab countries are going to have double and in some cases triple amounts of foreign exchange available for imports by 1975 compared with 1970. Most of these Arab countries purchase substantial quantities of arms, largely from the Soviet Union and Western Europe. 208/

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Chapter VII

THE WASHINGTON ECONOMIC COMMUNITY

**"No country that makes a grain deal with the
United States can be all bad."**

Art Buchwald

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~~SECRET~~A. Another Change in Leadership(b)(1)
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On 1 October 1971, [] resigned from the Agency to accept a position []

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[] This brought to an end his Agency career of more than 18 years, during which he had directed the economic intelligence activity of the Agency and brought it from its restricted -- and often disputed -- role of analysis of Sino-Soviet Bloc economic affairs to recognition as the US Government's most effective international economic research arm.

He was succeeded by [] the first Director to rise from the analyst ranks to this position.

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[] had come to ORR in June 1954 as an economic analyst []

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After service as an analyst, working first on the USSR and later on the European Satellites, he became Chief of the European Satellite Branch in October 1959. On November 1965, he was transferred to become Chief of the Western Europe Branch in the international Division. He became chief of that division a year later after a brief stint as Deputy Division

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Chief. After the establishment of OER in 1967 and the setting up of new research areas, he served briefly as Chief of the Communist Research Area and subsequently, from 11 January 1968 to 1 June 1971, as Chief of the International Research Area. He became Deputy Office Director on that date, when [redacted] left to become Assistant Deputy Director/Intelligence.

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[redacted] the new Deputy Director, had also spent his entire agency career in ORR/OER. He came to the Office as an analyst in the Communications Branch in 1956. [redacted]

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[redacted] he continued with that branch until September 1965, serving as its chief for the last two years. He transferred to the International Division in September 1965 as the Chief of the Latin America Branch. Following the reorganization of 1967, he became Chief of the International Services Division and served in that capacity until August 1970 [redacted]

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[redacted] only one year in order to assume the Deputy Directorship of the Office in October 1971.

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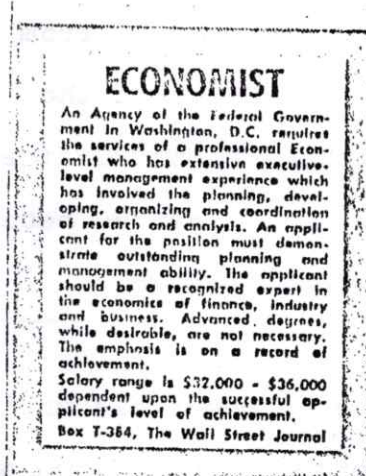
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The search for a successor to [] had included advertising in the Wall Street Journal. (See cut)

It soon became evident, however, that the Office itself was the only practical source for staffing its highest position in a fast-moving world of economic tensions and



crises. Both [] were well suited to direct the efforts since each had been actively engaged for many years in economic intelligence work on both the Communist and the Free World sides and with both developing and advanced economies. The continuity provided by their succession meant that the change in leadership was accomplished with no perceptible interruption in the operations or substantive productivity of the Office. This was fortunate indeed because [] decision to move

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to [] was quite unexpected;*

and it came at a rather awkward time. [] had

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been in the post of Deputy Director for only a few

months having replaced [] on 1 June 1971. Until

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[] impending departure was announced, the plan

had been for [] to leave in September []

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[] with [] acting as

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deputy director in his absence. This sabbatical had

to be canceled []

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[] a commitment which the Office

had been meeting since [] assignment at the

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end of 1967.

At the same time that these hasty personnel adjustments were being made at the top level of the Office and during the first several months of [] tenure, OER found itself under great pressure for

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* When he received the opportunity [] [] had less than two years to go before reaching the Agency's customary retirement age of 60. He felt that the transfer would enable him to continue in active service for a longer period and, of course, the job was tailor-made for his experience and talents. 209/ Unfortunately for him, he became a victim of the wide-spread purge of "Schedule C" office holders which took place following President Nixon's re-election, and he was retired in June 1973 at the age of 60.

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crash substantive production to cope with an unprecedented volume of national economic problems.

The [] Briefing Book was put in the works late in August while the [] briefing materials were also undergoing significant revision and expansion. The announcement of President Nixon's New Economic Policy in mid-August had brought a spate of support requests from the CIEP, the Department of Commerce, and other customers. Related issues such as []

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[] the distressing increase in expropriations of US properties in the LDC's were important problems requiring Office attention. The South Asia specialists were concerned with the burgeoning hostilities between India and Pakistan which climaxed in December with another brief war and the establishment of Bangladesh. Meanwhile the analysts dealing with the Communist world were finding that the new atmosphere of detente as symbolized by President Nixon's planned trips to China and the USSR was placing even more of a burden on them than the years of containment and confrontation had done -- and of course, there continued to be the problem of Vietnam.

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[REDACTED] Numerous briefings of sub-cabinet level officials took place, and in November [REDACTED]

[REDACTED] was briefed on the economy of the Soviet Union in preparation for a trip to Moscow. One of [REDACTED] last presentations before departing was a briefing of the President's Foreign Intelligence Advisory Board (PFIAB) in September. PFIAB's subsequent report to the President on the state of economic intelligence and its recommendations of a broadened concept of economic intelligence to include monetary, commercial and

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trade problems was doubtless a reflection of [REDACTED] well-established advocacy of such a concept.*

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B. Economic Intelligence on the Communist Powers
in an Atmosphere of Detente

1. USSR

For OER's components charged with following the Communist countries, 1972 was highlighted by the spirit of detente, climaxed by President Nixon's visits to China and the Soviet Union, and by the hope of increased East-West trade. As discussed above, although Free World trade with the Communist world had increased steadily and rapidly since the mid-1950's, US participation in this trade had been slight for a variety of reasons. Among these were the restrictions placed by the United States on trade with the USSR, including stringent export controls,** prohibition of credit guarantees, and denial of most favored nation treatment. 210/ The US restriction program aside, the major limitation on US-USSR trade was the Soviet inability to generate sufficient exports to pay for needed imports. The publicity given to the effort to increase US-USSR trade in the early 1970's, high-lighted by

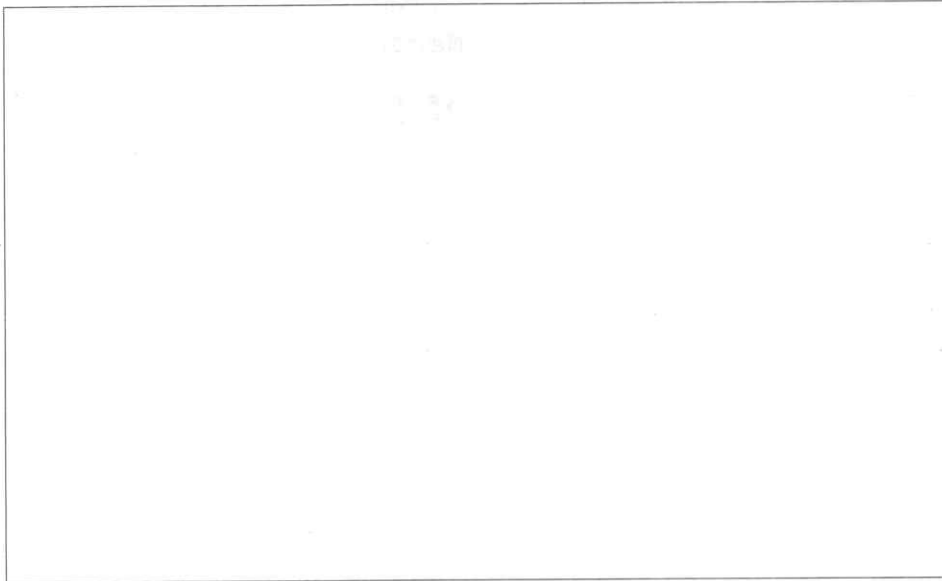
* See below, pp. 228-230.

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Secretary of Commerce Stans' visit to the Soviet Union in 1971, tended to obscure this basic problem. OER pointed out in December 1971:



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Some of the difficulties that had characterized East-West trading relationships were illustrated by the Soviets' efforts to enlist Western cooperation in the establishment a major truck-manufacturing complex. OER followed these developments closely. Several special reports were prepared for the Department of Commerce on the progress (or more accurately the lack of it) that the Soviets were making in this scheme. The Kama truck project was designed to produce 150,000 heavy diesel trucks a year.* This vast project, the largest unit of the

* Roughly the equivalent output of all heavy truck plants in the United States.

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Ninth Five-Year Plan, was bogging down in 1971 because of the difficulty in finding a Western automotive firm willing to cooperate with technical and financial assistance. Negotiations were carried on with a large number of firms

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In a support paper on the project prepared in June 1971 for the CIEP and the Department of Commerce, the office pointed out that the Soviets were retaining the option

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[REDACTED]

[REDACTED] The arrangement with Mack collapsed in September 1971, as the American firm recognized that the size and complexity of the project would require a degree of technical and financial assistance beyond the capabilities of any single firm. The USSR then shifted its tactics and began to enlist Western technical assistance on a plant-by-plant basis. This approach was proving more successful by mid-1972. [REDACTED]

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In 1972, the United States Government sought for opportunities to overcome some of the constraints on Soviet trade. A NSSM on US-Soviet trading relationships was laid on.* This evoked a number of

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support projects from the office, which while continuing to emphasize the short-run limitations on such trade, also attempted to lay to rest some apprehensions about Soviet credit-worthiness expressed in the Treasury Department; 214/ and to characterize the motives and tactics that could be expected on the Soviet side in any trade negotiations. 215/

A steady stream of VIP visits to Moscow in 1971-72 characterized the atmosphere of detente, and put a heavy support burden in OER's Soviet and East-West trade specialists. Secretary of Commerce Stans led the parade with a visit in November 1971. An agricultural trade delegation, led by Secretary Butz, followed in the early spring, and the climatic trip of President Nixon took place in May 1972.*

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* Of less national significance but of importance to the office was the departure

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OER's views on the state of the Soviet economy in 1972, as summed up in one of these publications, was as follows:

As a result of its emphasis on investment and industrialization, the USSR has maintained rates of growth of GNP that are high, although not exceptional, by international standards. In 1971 the GNP of the USSR reached \$549 billion, about 55 percent of the US level. While building an impressive industrial base, the USSR has been able to achieve near-parity with the US in military strength and to provide substantial increases in consumption levels.

... Despite these strengths and successes, the Soviet leadership continues to be concerned about three basic economic problems:

Declining growth rates. The Soviet economy grew more slowly in the 1960s than in the 1950s, and the rate of growth is likely to decline further in the 1970s. The goal of overtaking the US economically is as distant as it was a decade ago--the dollar gap between the national products of the two countries increased in the 1960s. Meanwhile, already behind many Western European countries in per capita production, the USSR has now been surpassed in this respect by Japan as well.

The productivity and technological gap. The fact that the USSR produces about half as much as the US with a labor force 50 percent greater suggests the magnitude of the Soviet problem in this area. The reasons for the relatively low productivity in the Soviet Union are primarily organizational and political: inefficient management practices, a cumbersome planning system, and the overriding priority given to increasing the quantity of production as quickly as possible to the detriment of efficiency and quality. Introduction of

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new technology and the replacement of old methods of production has been slow, and as a consequence, the technological level in many sectors is substantially below Western levels. Product quality also is a serious problem. Most Soviet manufactured goods, particularly machinery, cannot compete successfully in Western markets.

Consumer living standards. Although the Soviet population is far better off than it was in the years just after the war, per capital consumption in the USSR is still only one third that in the US, substantially less than the Western Europe, and less than in most East European countries. 216/

a. The Russian Grain Purchases

Although the celebrated Russian wheat purchases took place after the period of this history, much of the intelligence effort by OER reflected its previous work on Soviet agriculture, and some comments on the events are in order. In July and August 1972, Soviet foreign trade representatives negotiated the purchase of some 19 million tons of US grain at US subsidized prices -- the first of a series of transactions that had economic, political, and intelligence implications far beyond the time period or the subject matter of this history. The subsequent surge in wheat prices and of retail food prices on the US domestic market provided a field day for critics of US policy. Washington Post columnist Tom Braden [redacted] was typical:

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The wheat purchase proves that the Russians will deal with sharpness. No real estate purchaser with a shopping center in mind ever picked up single lots with more finesse than the Russians picked up US wheat while the Department of Agriculture sat in supine ignorance. Nearly a billion dollars worth of wheat and feed grains had been snapped up before a bureaucracy accustomed for thirty years to supporting farm prices woke up to the law of supply and demand.

There was also a failure of intelligence. might suppose that with thousands of Washington experts studying the Soviet Union, one of them might have pointed out that the spring wheat crop was a disaster and that it was awfully hot in Moscow in the summer of 1972. But nobody did, or at least if anybody did, nobody noticed. The tendency of official Washington not to listen to information it spends millions to obtain was once summed up by the late Allen Dulles who cited CIA's early warnings on the first Russian Sputnik: "The facts," he recalled, "didn't seem to have any impact." 217/

OER had of course, been reporting on the chronic weaknesses of Soviet agriculture for many years*. Moreover the Office's reporting on the 1971 Soviet grain crop had, as early as September 1971, emphasized that Soviet domestic needs, combined with commitments to its client states and insufficient reserves, would mean a continuing need for grain imports. 218/ Between 17 September 1971

* See volume II.

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and 3 August 1972, no fewer than CIA/OER publications had specifically dealt with this problem and its implications. 219/ For example:

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The fragility of the USSR's grain and livestock economy has been exposed once again... . Even with average weather, the USSR will probably buy more grain in 1972... . If the weather this spring and summer turns out to be worse than normal, the possibility of large additional Soviet imports of foreign grain would of course be even greater... . A large share of the imports would have come from the United States. 220/

Soviet negotiating tactics were also noted in OER's reporting:

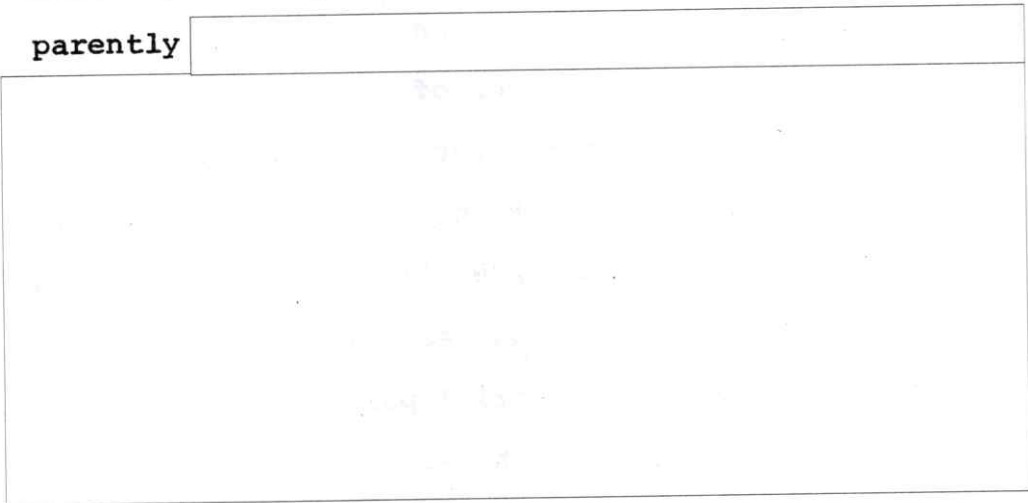
In their behavior at trade negotiations, the Soviets have sought to convey the impression that they are dealing with The United States from a position of strength. In the January 1971 discussions with US representatives, Soviet negotiators presented a possible LNG agreement with the United States as a Soviet concession. Similarly, in discussions of a long-term grain agreement they are demanding "concessional" terms, including credit terms well beyond what can be legally offered. This sort of behavior rests on a strong tradition among Soviet foreign trade representatives, who place a great premium upon stimulating competition among prospective partners and upon beating the capitalists at their own game. While the Soviet negotiating stance is tough, however, the USSR evidently wants to conclude a trade agreement with the United States; not only in order to acquire advanced technology and equipment and agricultural products, but also to demonstrate that the US has accepted the USSR as equal. 221/

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Not only did CIA provide ample and continued warning of the Soviet need for grain during the months preceding the Soviet purchases, it was apparently



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If there was an intelligence failure, it was apparently the result of the Department of Agriculture's estimate -- as opposed to OER's -- that Soviet grain reserves were so large that even the poor winter crop results in 1972 did not indicate any major need to import. Based on this judgment and following its traditional responsibility of promoting US agricultural exports -- in an atmosphere of US-Soviet economic rapprochement -- the Department delayed adjustments in the export subsidy and in effect presented the Soviets with a windfall subsidized price for the record-size purchases.

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As a result of the US-USSR detente -- dramatized by the grain deal -- the oft expressed reservations about the potential of US-USSR trade have had to be revised. In 1972, the US emerged as an important creditor of the USSR with more than \$800 million in loans, including \$500 million Commodity Credit Corporation credits for the grain purchases, and some \$200 million in Export-Import Bank credits and guaranties for the Kama truck plant and other industrial purchases. For the future -- and beyond the scope of this history -- active consideration was being given to such self-liquidating projects as a US-financed natural gas project with an assured export market in the US and a similar arrangement involving US plant, equipment, and technology sales in exchange for Soviet ammonia, urea, and potash. Thus, at the time of writing, OER's forecast with respect to potential US-USSR trade was being expressed in tones of optimism that had not been used in the previous 23 years of economic intelligence reporting on the Soviet Union:

US-Soviet trade has increased much faster than total Soviet trade with the West in the past two years, largely because of US exports of agricultural

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products for delivery in 1972 and 1973. Exports of US machinery and equipment are also rising. About \$800 million in US credits have been made available to the USSR since June 1972 to help finance these exports. Continuing purchases of US equipment and grain by the Soviets should ensure a major US role in the USSR's economic ties with the West. US participation in major Soviet projects to develop fuels and raw materials will be a major factor in increasing US-Soviet trade. 223/

2. China

Interest in China, which was always high, took a quantum jump on 15 July 1971, when President Nixon announced his plan to visit China and to seek the normalization of relations between the two countries. At about the same time, plans were being laid for an updating of the (Congressional) Joint Economic Committee's compilation of papers on the Chinese economy. As in the earlier study (1967), OER was called upon for major contributions to this collection. The FY 1972 effort on China by the Office not only rose to a new peak but also addressed itself to new problems, including the possibilities of US-China trade. Because of the gradual relaxation of US trade controls which had preceded the President's announcement, a preliminary assessment of the trade potential had been made in May 1971. The prospects were adjudged as extremely limited. Except for the

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high-technology items from the United States and "orientalia" from China, it was hard to visualize any significant trade items that could break through the established trade patterns and relationships. In the long run, Chinese oil exports might have some potential, but China's petroleum reserve position was not well enough established to justify even a rough estimate of its size. 224/

Support activities for the Presidential visit to Peking ranged from the specific to the general.

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With political aberrations, such as the Great Leap Forward (1958-60) and the Cultural Revolution (1966-69), presumably behind it, the Chinese economy appeared to be on an even course. Assuming no new flare-up of radical economic policies or a prolonged spell of unfavorable weather, prospects for substantial economic growth were considered

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good. But the growth of foreign trade was expected to be slow, and particularly in the potential for US-China trade -- as brought out in the earlier paper -- limited. China's predicted stature for the 1970's with respect to the rest of the world was summarized as follows:

In general, China will continue to depend on the outside world for new technology and modern machinery in the 1970s. China enters the international arena as a back runner in the technological race. To be sure, China will draw rapidly ahead of other large low-income nations, such as India and Indonesia, which lack internal momentum in investment and are burdened by crushing international debts. At the same time, China will be rapidly falling behind its neighbor Japan in total and per capita output since the Japanese economy is growing at least twice as fast on a far larger base. All the leading industrial nations will be devoting substantial resources to research and development and to the modernization of their industrial facilities. China with its heavy commitment to defense will be hard-pressed not to fall farther back of the international pace-setters. 223/

An innovative section of this report, entitled "Questions Frequently Asked About the Chinese Economy" provided quick answers on matters of interest that had not been addressed in the body of the paper. One of these attempted to lay to rest recurrent concern about China's covetous intentions toward the "rice bowl" of Southeast Asia" -- by

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pointing out that the area's surplus is at most 5 million tons, only 2 to 3 percent of China's grain production. Other points made in this section were that the distribution of income and perquisites in China had reached a degree of equality not found in any other major country and that the rank-and-file Chinese people were much better off in a natural sense under the Communists than before 1949. In this connection, however, a chilling statistic was given: "The 5-10 percent of the people at the top in pre-Communist days fled the country, were killed, or were dispossessed." Thus the egalitarian gains had been achieved through the effective removal of from 35 million to 85 million people.

The judgments made in this report were a modest reflection of the continuing efforts made by the Office to unravel the mysteries of the Chinese economy. At the same time more detailed material was being prepared for the second compendium of papers on the economy for the Joint Economic Committee (JEC) of the Congress. 225/ This was published in May 1972

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The President's trip in early 1972 was followed by a mission undertaken by Kissinger in June of that year. In response to the need for a current economic assessment, the China Division issued a report describing the state of the economy in mid-1972. Emphasis was placed on developments since the Presidential visit and -- in response to the joint declaration made at the visit's conclusion calling for the facilitation of trade, -- on the current status of Sino-US trade. Although the Chinese economy seemed to be "progressing

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smoothly on all fronts", its foreign trading activity would probably increase more slowly than domestic economic activity because "Peking stresses the principal of self-sufficiency and because the agricultural sector can only gradually provide more goods for export." 226/ The new era in US-China trade was more symbolic than substantial, and total two-way trade for 1972 was expected to be only \$40 million to \$50 million.

C. The Broadening Concept of Economic Intelligence

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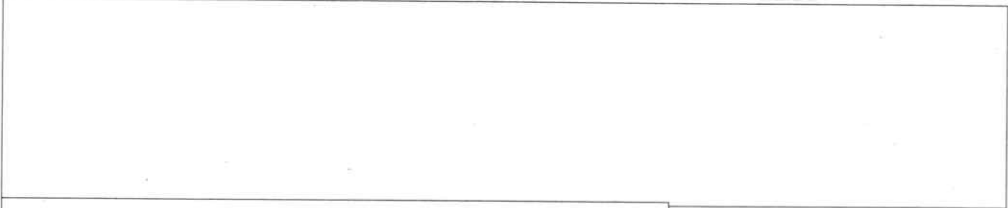

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OER's work had anticipated this judgment by many months as its record of support to the CIEP, Treasury, Commerce, and other bodies attests. With respect to the broadening and updating of requirements to reflect the expanded interests of the US economic community, on 9 June 1972 the Office appointed a senior economist [redacted] to work full-time on these problems with the title of Special Assistant for Requirements and Community Affairs (SA/RCA). In addition, the EIC established a new Subcommittee on Requirements and Coordination, which was to have responsibility for ensuring that all statements of intelligence priorities and all collection guidance

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material adequately reflected the interests and needs of the entire economic community. The SA/RCA was to chair this subcommittee, as well as represent the Agency on the NSC's Consultative Group on International Economics with the other member agencies of the Washington economic community.* 228/


 Thus, although
the NSCID which delineated primary responsibilities for the various substantive fields of intelligence continued in 1972 to allocate economic intelligence on the Free World to the State Department, it did not place any jurisdictional limit on CIA. 229/
It was in any case apparent that the Department's resources were inadequate to handle the Free World responsibility on its own, and as has been thoroughly documented in this history, the Department has continually turned to OER for economic intelligence support on the Free World.**

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~~SECRET~~D. The Reorganization of 1972

As the first five years of OER's existence drew to a close, a major reorganization of its personnel resources again became necessary. There were three primary purposes in the reorganization proposed by [redacted]

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1. The elimination of the area level of supervision and review. The purpose of the area concept as it had originated in ORR in 1952 [redacted]

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[redacted] was to provide expert leadership and substantive guidance in clearly delineated fields of intelligence: geographic and economic. The same rationale applied, in some degree, to its continuation after the departure of the geographic intelligence function from the Office [redacted]

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[redacted] When the Military-Economic Area of ORR was separated out to form the nucleus of OSR, the area concept was dropped briefly. It was revived during the chieftainship of [redacted] in the new OER because [redacted] felt that he was unable to provide adequate substantive guidance and project review to four (later five) divisions. It is doubtful that [redacted] entertained thought of any

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such inadequacies, but he was probably reluctant to relinquish the grade structure that the area concept justified. By the time [] took over the Office, the usefulness of the area level was, however, questionable. As with [] there was no real question of adequate guidance, and the additional level of review interposed more of a delaying factor than a substantive improvement. The demands of rapid response to policy support requests made it apparent that a streamlining of the paper flow was needed. Since it was now possible to eliminate the area positions and establish key deputy slots at the division level while avoiding a significant dilution of the Office grade structure, [] proposed that the areas be eliminated with five new divisions reporting directly to him (see Figure 3).


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2. A better distribution of the growing workload of Free World research. The existing structure had all the Free World responsibility, save Indochina, in one division, with some support from the functional branches of the International Services Division. The [] proposal was to set up two geographic divisions for Free World research, again excluding Indochina. The new divisions, Atlantic/Pacific, and Near East/South Asia, would


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include, not only a revised group of area branches, but appropriate functional branches, e.g., Petroleum Branch and Trade and Monetary Analysis Branch in the Atlantic-Pacific Division and Trade and Aid Branch and International Transportation Branch in the Near East/South Asia Division.

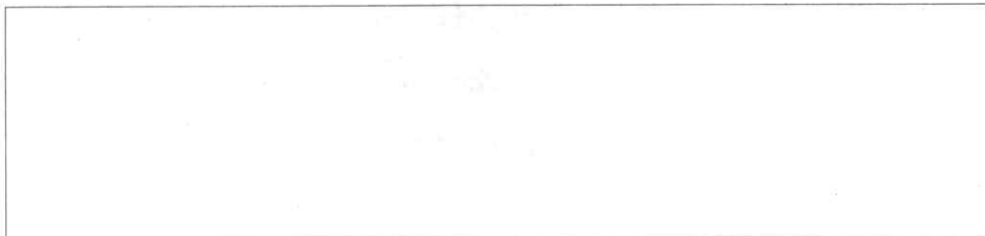
3. To reorganize the continuing intensive research effort on international trade and finance. The work on international monetary and financial problems was in this move elevated to branch status from its existing location in the Atlantic Mediterranean Branch. The new Trade and Monetary Analysis Branch was, as indicated, placed in the new Atlantic/Pacific Division 



 The two divisions dealing with Communist countries were continued with only minor change.

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The new organization, which became effective on 1 July 1972, is shown graphically in Figure 3 .



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The chronic geographic-functional dilemma continued under the new organization. As in the reorganization of 1967, the tilt in 1972 was toward a geographic solution. The five-divisional set-up was now wholly geographic, but several functional branches continued. The branches of the defunct functional division, International Services,

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were distributed among the geographic divisions -- insofar as possible each went to the division which had the greatest direct need for its expertise, e.g., the Trade and Monetary Analysis Branch to the Atlantic/Pacific Division. The proper locus for the Petroleum Branch was less obvious. It was placed in the Atlantic/Pacific Division because the major consumers of petroleum were also in that division, although the major resources and reserves of its primary product are, of course, in the Near East, an area under the jurisdiction of a different division.*

* As of the time of writing (mid-1973) the Petroleum Branch had been renamed International Energy and Resources Branch, having taken on responsibility for international energy and key resource problems on a global basis.

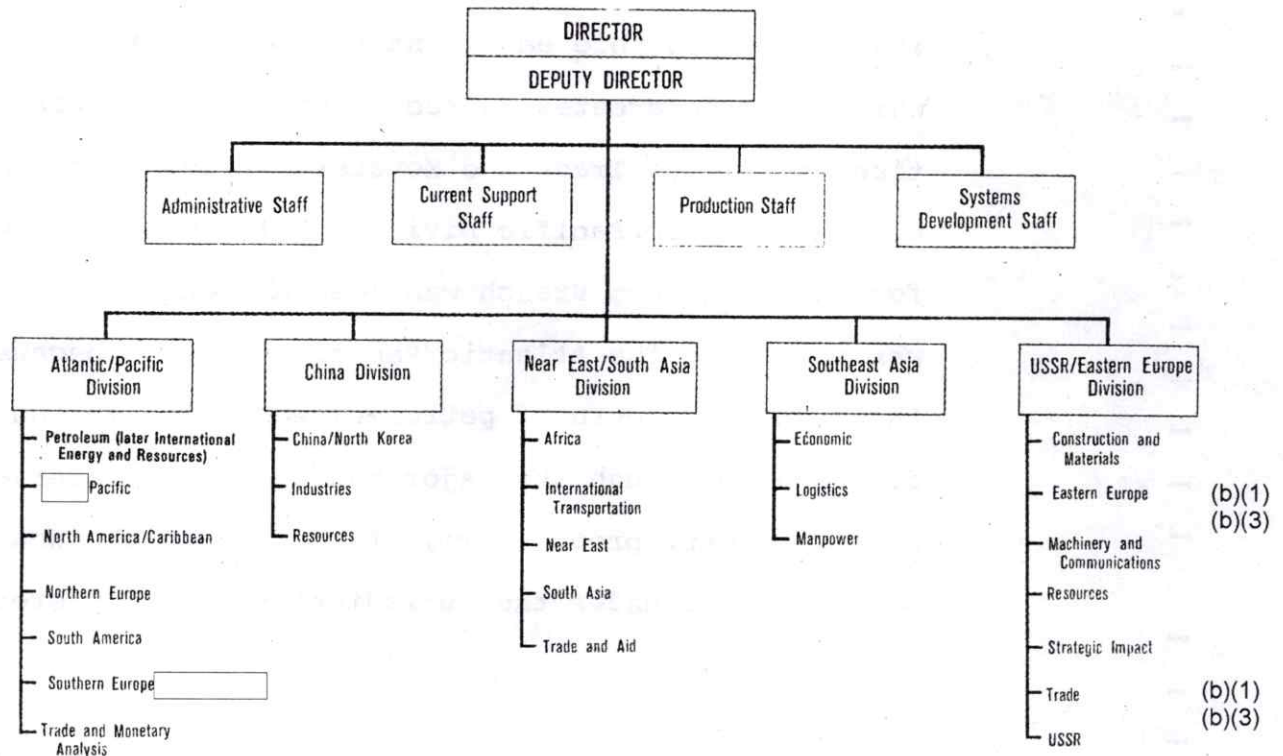
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OFFICE OF ECONOMIC RESEARCH

Figure 3



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~~SECRET~~**Chapter VIII****EPILOGUE**

"In particular, information concerning economic threats to our national interest and our access to key national resources will take on ever-increasing importance."

W.E. Colby

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~~SECRET~~A. Retrospective

The three volumes of this history have traced the development of economic intelligence in the Central Intelligence Agency over a 22-year span. During this period, economic intelligence evolved functionally and conceptually far beyond the limits laid down by those initially charged with responsibility for its production in the Office of Research and Reports. This Office was originally conceived as a "catch-all" for a number of intelligence functions, which were essentially the left-overs when the estimating function was removed from the liquidated Office of Research and Estimates and elevated to top status in the hierarchy of finished intelligence production activities. These left-over functions, which were among a group officially referred to in the National Security Act of 1947 and in many subsequent directives and orders as "services of common concern," included economic intelligence and a number of other

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unassigned activities of the intelligence community. It was ORR's first chief, [redacted] who first defined economic intelligence as a community function and proposed that the Agency and in particular his office take prime responsibility for it with respect to the Communist World. This primacy was not readily admitted by other agencies, but the aggressive defense of the Office's role by [redacted] successor, [redacted] and the growing skill and sophistication with which the Office applied itself to the task under the guidance of its first Chief of Economic Research, [redacted] had by the end of the 1950s established ORR as clearly the primary producer of economic intelligence on the Sino-Soviet Bloc within the intelligence community. Within the Bloc, of course, the Soviet Union was the principal target, and [redacted] laid down explicit guidelines for the assault on this target. The secrecy which surrounded economic information about the Soviet Union, particularly in Stalin's time, required -- in [redacted] view -- a meticulous and persistent piece-meal assault, justifying the often used metaphor of "jig-saw puzzle" as descriptive of the economic intelligence process.

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The assault on the Communist economies was, of course, geared from its inception to the consideration of the USSR as the greatest potential enemy of the United States -- with Communist China and the European Satellites in close support. Intelligence was produced primarily in order to provide the policymakers with the best possible judgments on Communist economic capabilities, vulnerabilities, and intentions. Implicitly, these factors were important because of what clues they could give to Communist military strengths, weaknesses, and purposes.

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was, conversely, little concern in [] day with Soviet economic well-being per se. The questions of Soviet GNP and its rate of growth or of a "Soviet economic challenge" are not even raised in 1951 when [] wrote his guideline paper on methods and goals of economic intelligence and analysis.

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The year 1953 stands out in the history of economic intelligence in ORR for several reasons -- both internal and external. Internally it was marked by the actual establishment of the Economic Research Area, which had existed on paper since 20 August 1952, and by the creation of an all-source research organization, ending the "split personality" of the Office

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The external event that had a significant impact on economic intelligence in 1953 was the death of Stalin. The Soviet economy under Stalin had, as indicated, been characterized by extreme secretiveness -- even a report on the production of samovars was considered a state secret. With Stalin's demise, the Iron Curtain was slowly and partially lifted, and economic information on a carefully controlled and often misleading basis (but rarely deliberately falsified) gradually became available. This change was also reflected in the Satellite nations. In addition to the relaxation of information control, Stalin's death led to a number of changes in Soviet economic policy,

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which became matters of great interest to the Office changed with the responsibility of interpreting that policy.

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Another policy change, after Stalin's death, was an expression of concern for the economic well-being of the Russian consumer. Originally voiced by Malenkov in August 1953, this policy change was given great prominence by the boasts and threats of Khrushchev whose challenges to the United States to an economic growth race gave a new dimension to the economic intelligence mission. Intelligence on the Soviet military threat was, at the same time, becoming more sophisticated -- and more urgent -- with Soviet progress in missiles and space. ORR's expertise in a wide variety of

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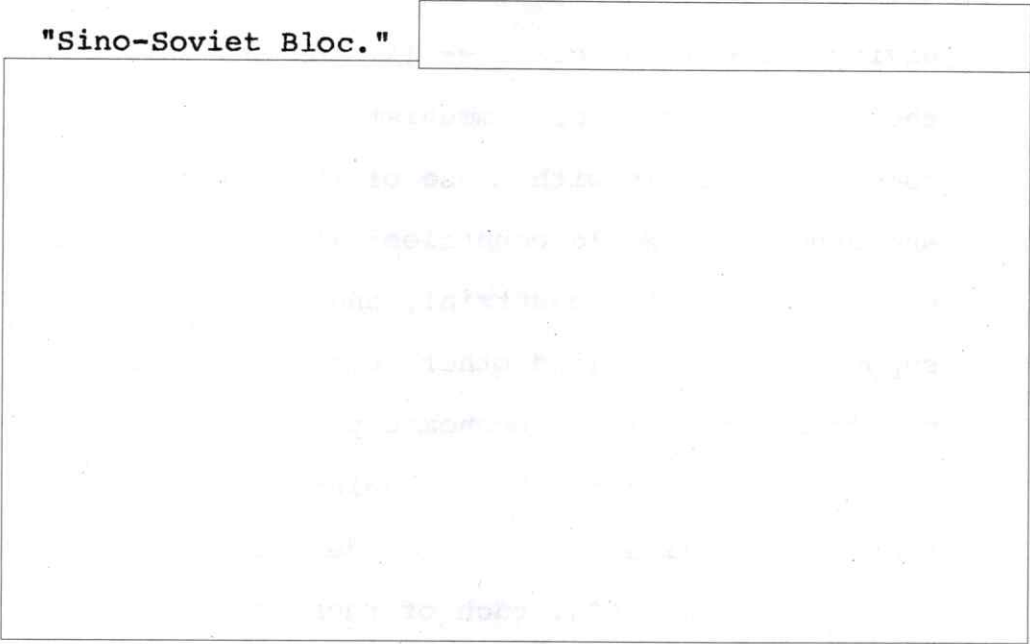
technical and industrial specialties was increasingly called upon to serve US security interests in this field, while the economic growth threat was calling for more sophisticated theoretical studies. By the advent of the Kennedy administration in 1961 the economic intelligence mission was conceived as having three major goals -- (1) the analysis of the Soviet (and other Communist) economies on a comparative basis with those of the United States and other Free World countries; (2) the analysis of the technical, industrial, and other economic support to Soviet (and other Communist) military postures; and (3) the economic penetration of third world countries by Communist material, technical, and military aid and trade activities.

By the mid-1960s, each of these major economic intelligence goals had become institutionalized, and organizational adjustments had been made to accommodate them. Military economics had become first a divisional and then an area responsibility with its own specialized sources, analytical techniques, and consumers. The analysis of Communist economic penetration activities had led to increasing concern with the internal economies of the target countries, and Free World economic

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intelligence had been elevated to division status. Economic analysis of the Soviet Union, Communist China, and the East European Communist countries was recognizing the individuality of the target countries to a far greater extent than had prevailed in the days of the "Soviet orbit" and the "Sino-Soviet Bloc."



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Most of such expertise as existed on these sectoral specialties was by this time engaged in back-up studies for the strategic analysis of the Soviet missile threat and also being tapped for studies of transportation, communications, and other support facilities for the growing "insurgency" in Southeast Asia.

ORR's acknowledged competence in "logistical" evaluation was not simply a phenomenon of US

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involvement in the Vietnam War. The Office produced what was acknowledged to be the best finished intelligence of this character in connection with the Chinese Communist buildup across the straits from Taiwan in the 1950's and prepared a well-received study of Vietnamese logistics at the time of Dien Bien Phu.

The Office's heavy involvement in Vietnam is illustrative in the broadest sense of the many facets of economic intelligence. The logistical analysis side of this has been mentioned above. Evaluations of the state of the North Vietnamese economy were more in the traditional mode of ERA responsibilities. The state of South Vietnam's economy has been perhaps of even greater importance to US policymakers, and the Office's periodic and special reports on this subject have provided significant background for the programs designed to keep this nation economically viable. Target studies, bomb damage assessment, and supply routes constituted other facets of ORR/OER's Vietnam support role from mid-1965 on, calling on a variety of specialties in the industrial and transportation fields. The fragmentary and contradictory evidence on enemy manpower resources

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and military force levels has put a premium on the development of statistical skills and techniques to arrive at realistic judgments on these matters. Finally, in the latter days of the Vietnam difficulty, OER's developmental economic resources were called upon to prepare scenarios on the long-term economic development possibilities for South Vietnam.

Until the establishment of OER in mid-1967, the Office's work on Free World countries had centered on the countries that were major targets of Communist economic penetration. The relinquishment by the Department of State of its role in the preparation of economic chapters for the National Intelligence Surveys had, however, put the burden on ORR to devote some effort on all Free World countries to fill this gap. Thus the Department was in a poor position to challenge DCI McCone's formal insistence in 1965 on maintaining a Free World capability. By 1967 there was developing a market for policy-oriented Free World intelligence studies from the Office that went beyond its customary, i.e., Cold War concerns. The growing economic vigor of the major countries of

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Western Europe was initially welcomed as a manifestation of Free World strength in the Cold War arena, but a less welcome result was the growing inadequacy of the dollar-dominated international monetary system and a related decline in the US competitive posture. The new Office found a ready market among the policy departments for its studies on these developments. Its unique contributions were made possible by its all-source access and were fostered by the objectivity and candor of presentation. With this beginning, the Office soon found itself called upon for more detailed research on the major Free World countries as trading partners and rivals of the United States in an economic environment which its strength had made possible but which it could no longer dominate.

By mid-1972, the Office's major substantive interests were direct reflections of the nation's major economic concerns: the Communist economies were of concern not only as the substance behind their respective military postures but also as potentially significant trading partners in an increasingly interdependent world; the major Free

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The break-down of the fixed exchange rate system and the changed role of the United States and its currency in the international monetary structure were of parallel concern. At the same time, international commodity problems, aggravated by unprecedented demand for petroleum, wheat, soybeans, and other grains were becoming an important area of Office policy support activity. This concern with critical resources and the increased consideration to international rather than bilateral economic problems also meant continual attention to the countries of the developing world -- an attention that went far beyond the earlier simplistic consideration of them as pawns in the Cold War.

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Thus at the close of the period covered by this history, the Office's leaders -- past and present -- had every reason to be proud of its accomplishments and its recognition as the largest and most authoritative organization in the US Government engaged in foreign economic research, in support of both national security objectives and national economic objectives.

B. Prospective

It is a wise historian who leaves to his readers the luxury of forecasting the future. Thus although the 22-year history of economic intelligence as a significant CIA function is characterized by a virtually unbroken trend of increasing responsibility and acceptability as a national policy support activity, the temptation to forecast a continuance of this trend will be resisted. There will certainly always be a need for objective economic intelligence, and the Agency's chief

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asset has always been its claim to objectivity. When policy decisions are in the balance, however, policy departments become jealous of their prerogatives, and the organization that stands aloof from the inevitable bureaucratic squabbles does not always come out on top. The reputation for objectivity which ORR wore proudly when it had won an established position as the authoritative voice on the Communist economies was not so easily maintained when its successor Office undertook to challenge the judgments of those "in the field" in Vietnam. Likewise the attempt to inject vigor and forthright judgments into NSSM's that would otherwise remain -- in phrase -- "homogenized pap" as a result of accommodating the varying policy department views have not always been welcomed by the consuming agencies.

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Most of the consumers of the economic intelligence product, both within the agency and within the larger government framework, are concerned with operational activity in the broad sense. All too frequently, it has fallen to ORR/OER's practitioners of the "dismal science" to point more to the difficulties than the potentialities of economic

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action programs. The Office's frequent skepticism about the effectiveness of economic denial activities -- whether embargo, sabotage, bombardment, or blockade -- has been documented in some detail in these volumes. However sound the judgments expressed, they probably have not helped to win the administration of the architects and advocates of such action programs.

Sociologists and some historians and political scientists are fond of looking upon organizations as having organic characteristics of birth, growing pains, youthful vigor, maturity, senescence, and death, and the rise and fall of a number of agency components provide examples to support this viewpoint. At a time when OER appears at a high point of influence and effectiveness, it would be unwise to expect that it can forever avoid the life cycle described by social theorists. Threats to the present office posture could take several forms. A strict view of the functions and purposes of national intelligence might be enforced by some future administration, or Congress, or even a DCI, and result in a cut-back on the present scope of economic intelligence activity. An aggressive

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Secretary of State (or Treasury or Commerce) might effectively oppose the growing dependence of his Department on the information -- and inevitably -- the judgments of outsiders. The scenarios of change in the role of OER as a US Government support arm are in fact endless, and they do not depend necessarily on errors of omission or commission by the Office.

The strength that the Office has and that gives hope for an effective role in the future is simply its reputation for prompt, thorough, and objective response to policy needs. This reputation has been gained on a wide front. Most of the officials in other government agencies that have been the beneficiaries of the Office's support work will, it is hoped, be more often grateful than jealous. The reputation of the Office in the academic community has been earned by those professional research products that have been publicly released

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but also because of the ready response to most requests for support from individual Congressmen. The press also has had occasion to compliment the work of the office on a number of occasions.

It is manifest that during the period covered by this history, CIA has had a mixed press, and Agency leaders have been touchy on the matter. On the not infrequent occasions when ORR/OER activities have reached the public prints, however, it has almost always brought favorable notice to the Agency. This was outstandingly the case at the time of Allen Dulles' open testimony before Congress in 1959.* Again in 1964, the publicity surrounding CIA's only press conference -- setting aside the unfounded speculation about bureaucratic machinations -- reflected favorably on ORR's knowledge of Soviet economic affairs.**

In the spring of 1967, favorable notice was also taken of the office's contribution to the Joint Economic Committee's compilation on China, "An Economic Profile of Mainland China." According to one columnist,

* See Volume I.
** See Volume II.

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...the CIA paper is especially interesting. It shows the CIA carrying out an intelligence function which it can -- and does -- perform superbly. This is the painstaking collection and assembly of economic and financial data which help American officials to make informed decisions on foreign policy. 231/

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Past reputation is, of course, not enough.

"What have you done for me lately?" is the name of the game in bureaucracy as elsewhere. Thus to the extent that the future of the Agency's economic intelligence activity is in the hands of its practitioners, it will continue to depend on their integrity, their objectivity, and their dedication to the service of national policy. If this statement is more platitudinous than insightful, it is a reflection of the uncertainty of the profession, especially of its dependence on forces over which it has little control.

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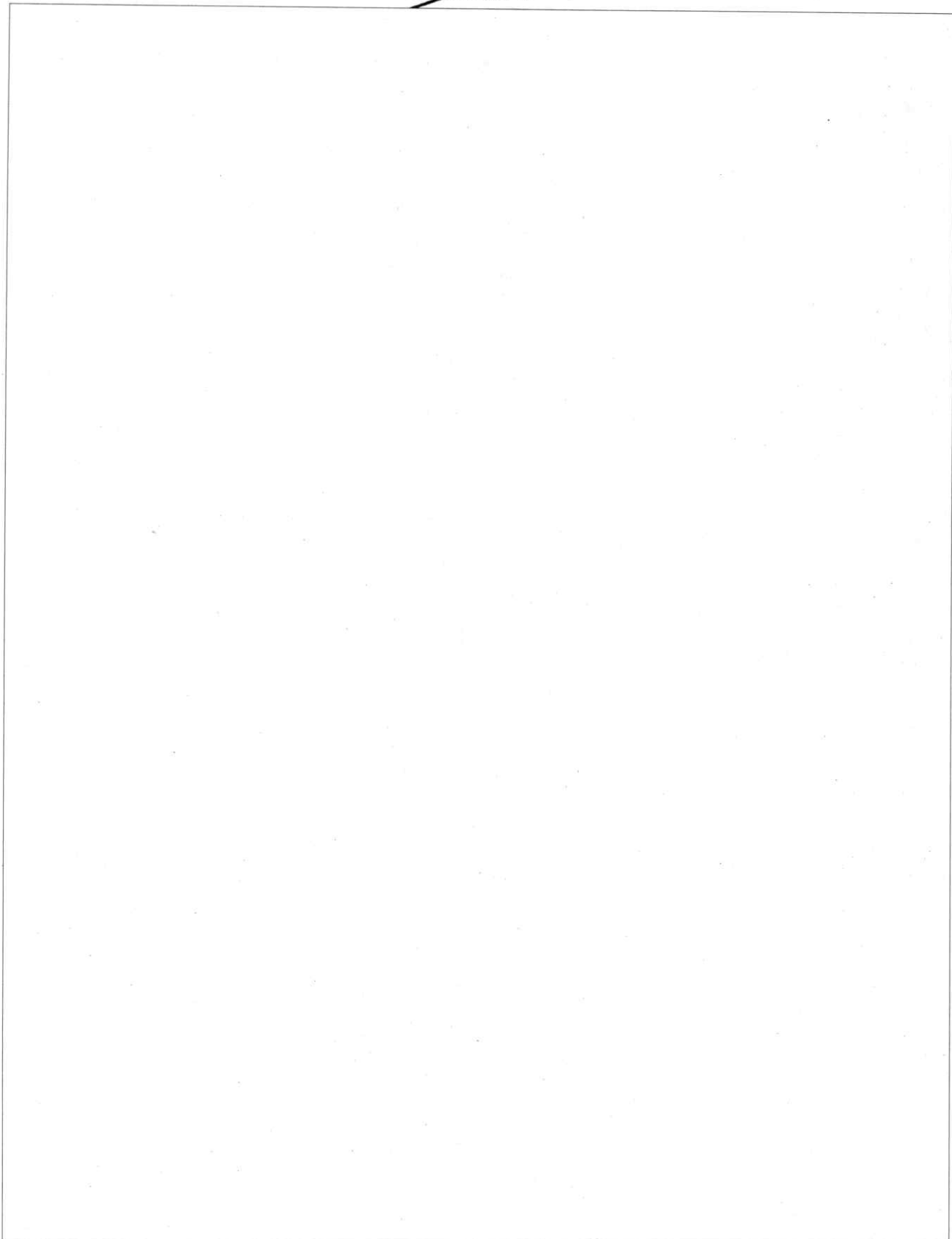
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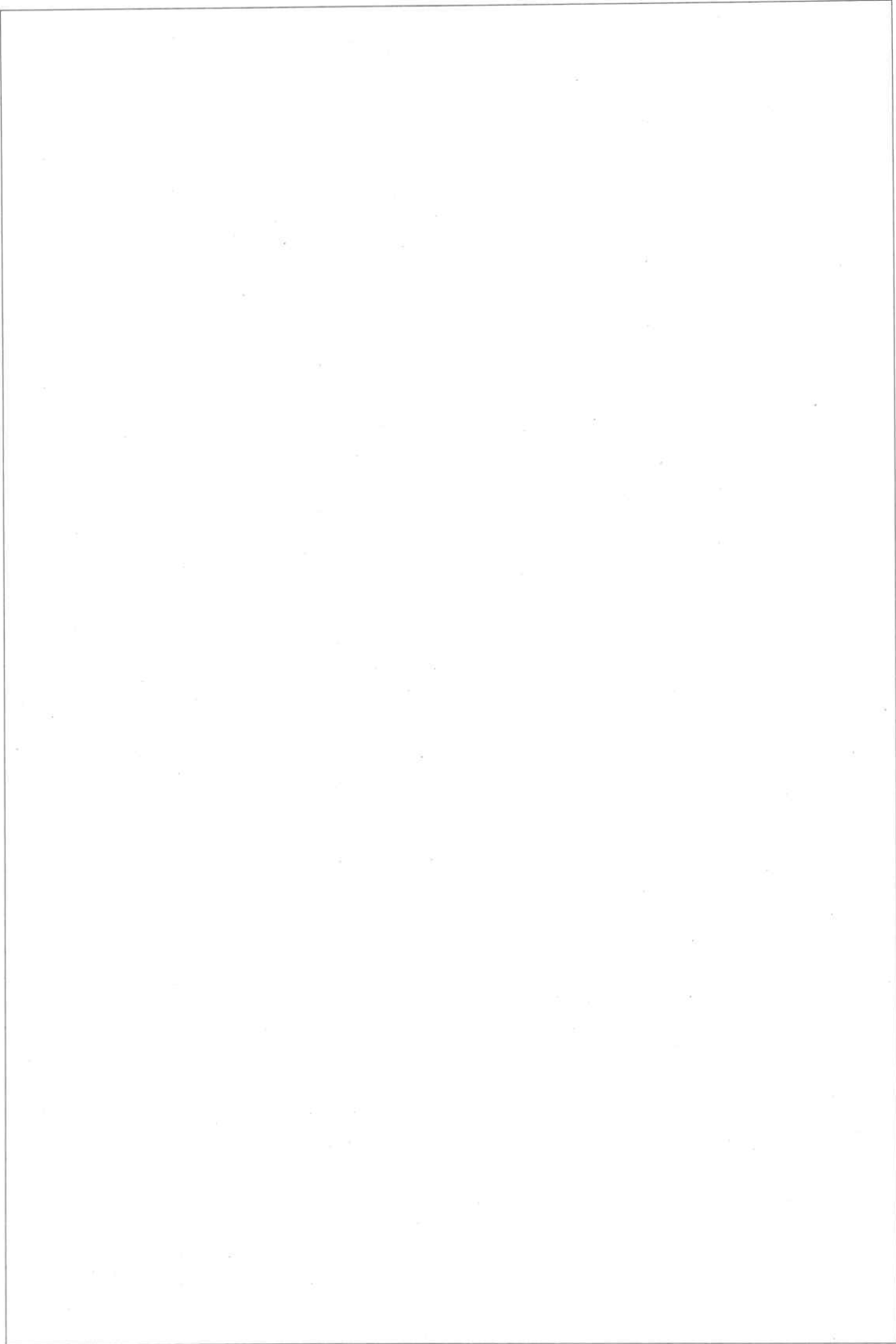
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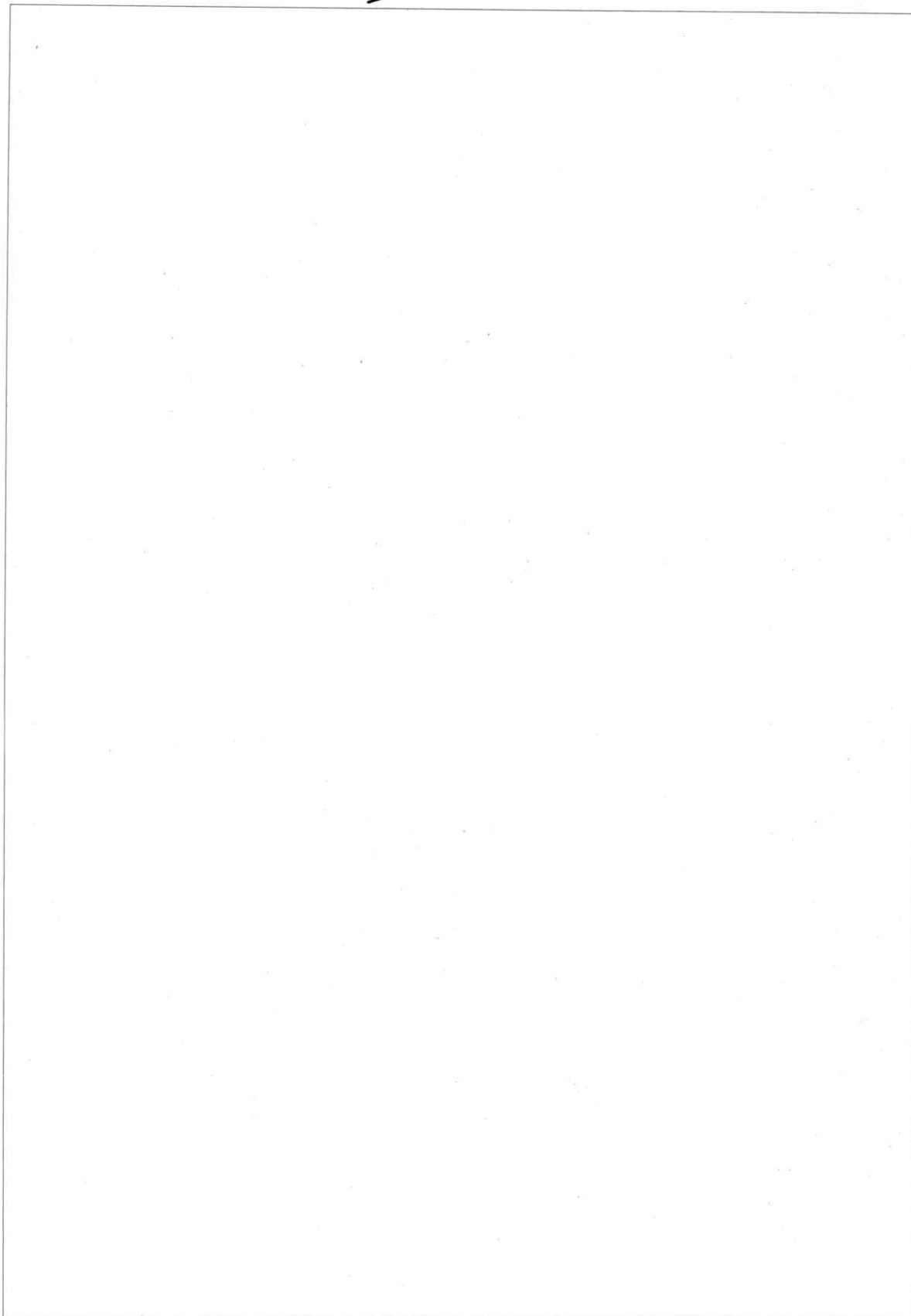


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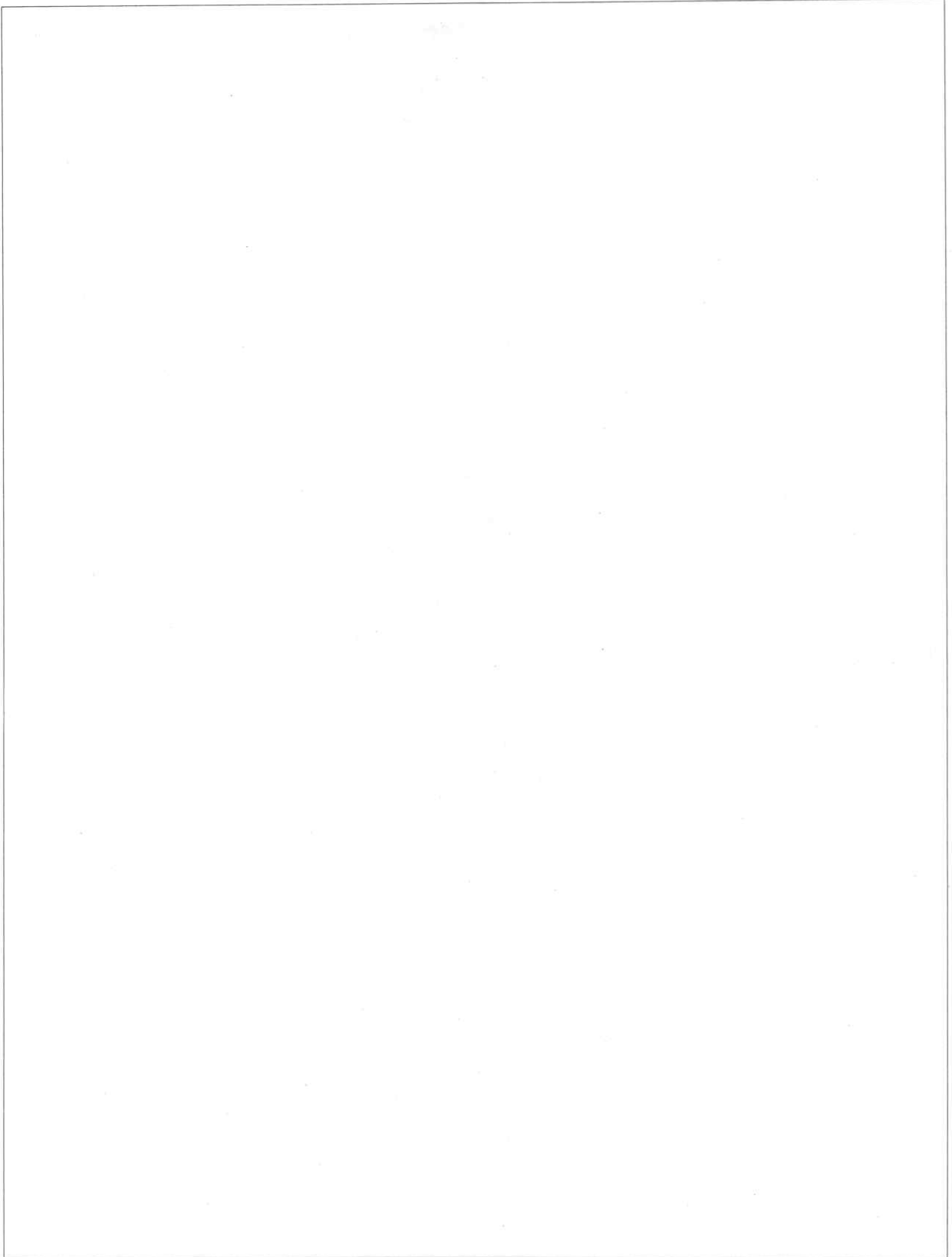
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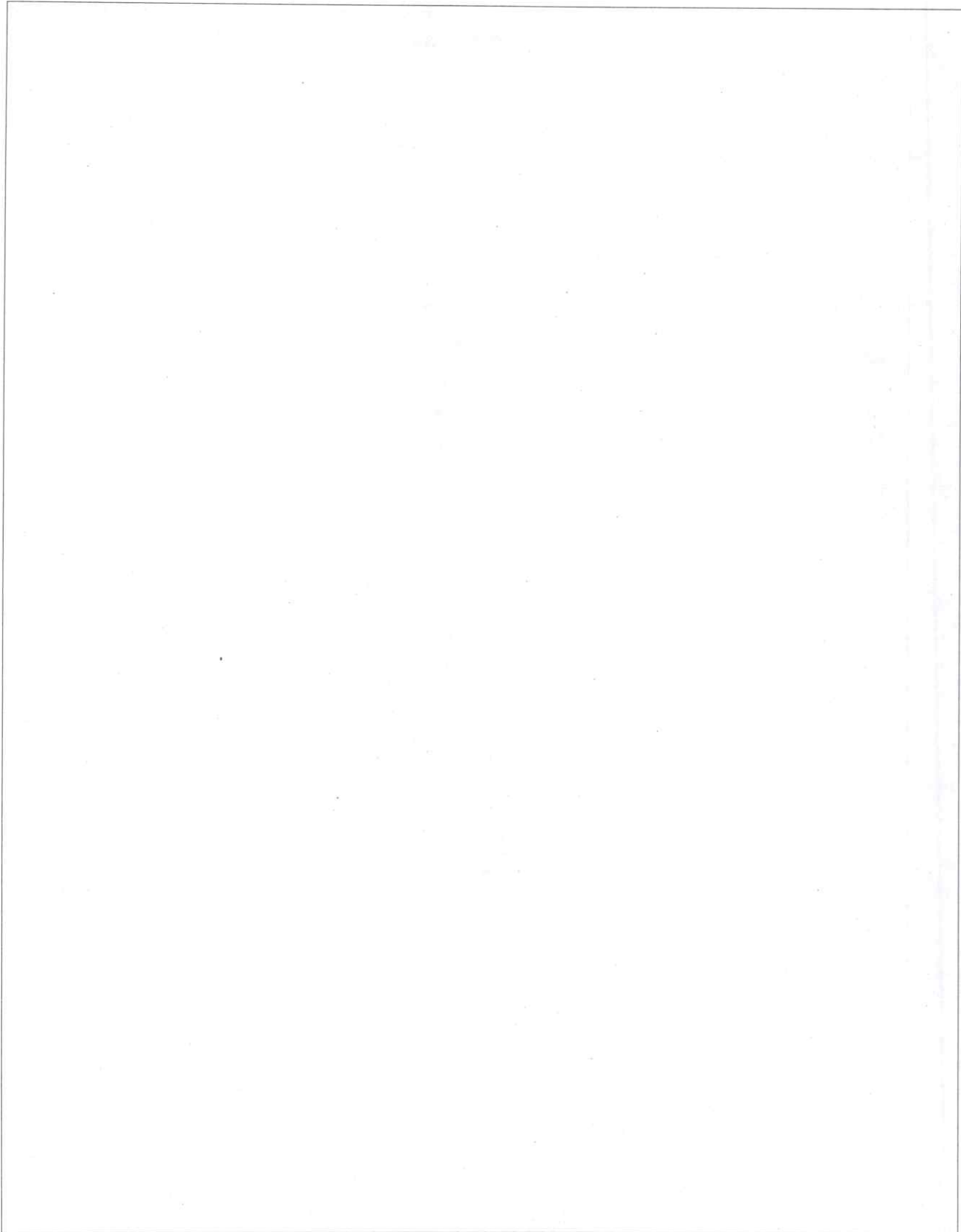
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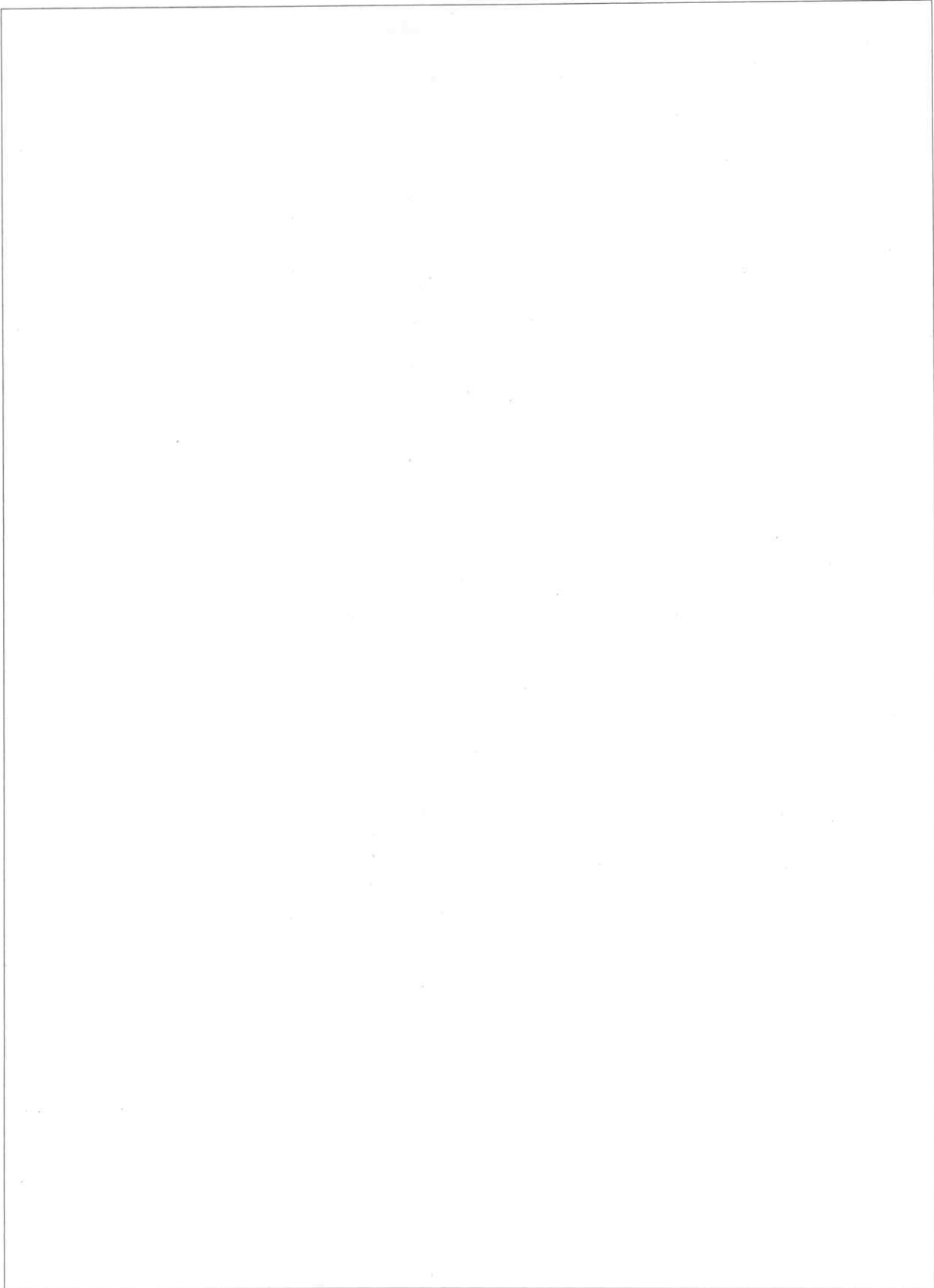
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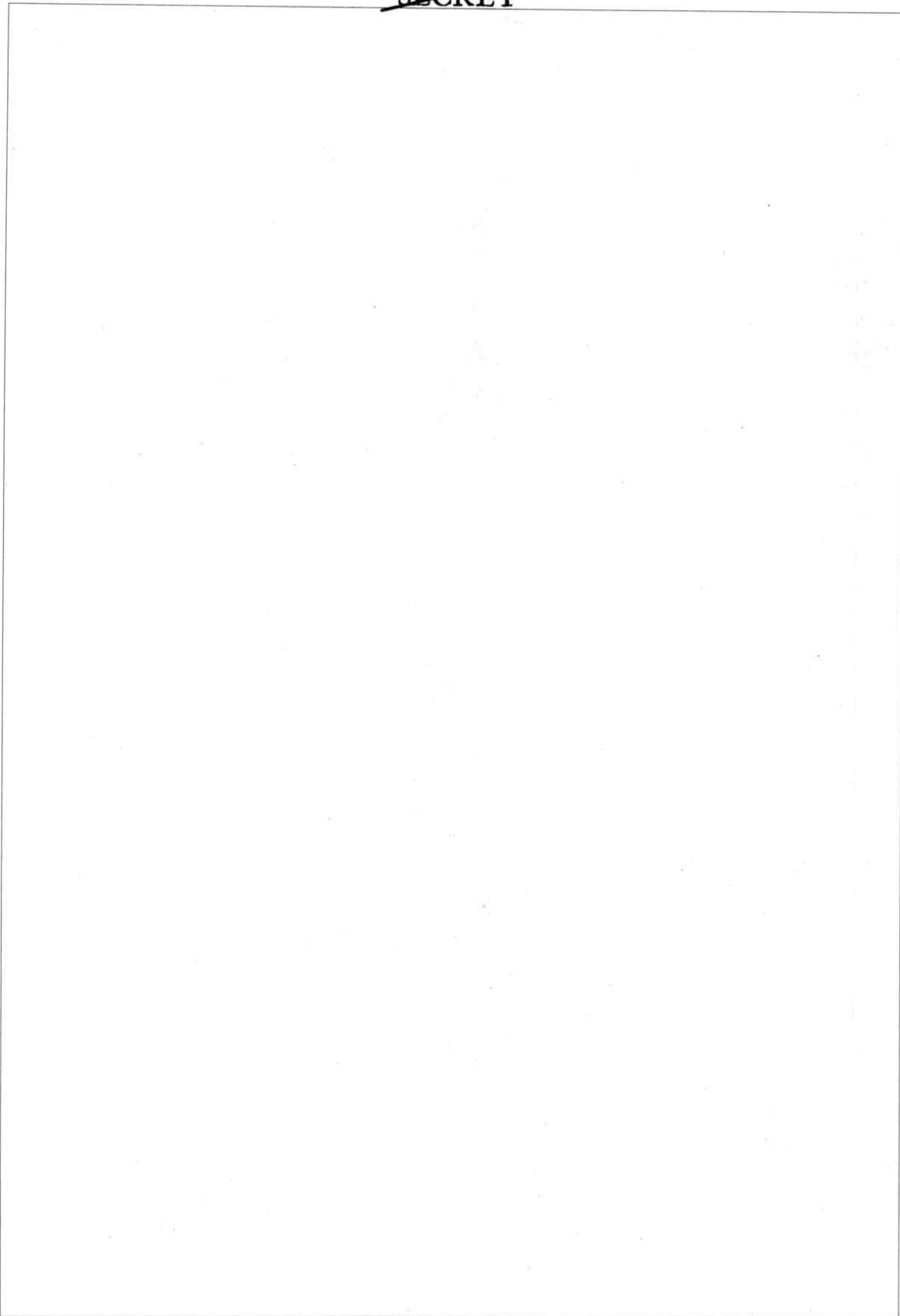
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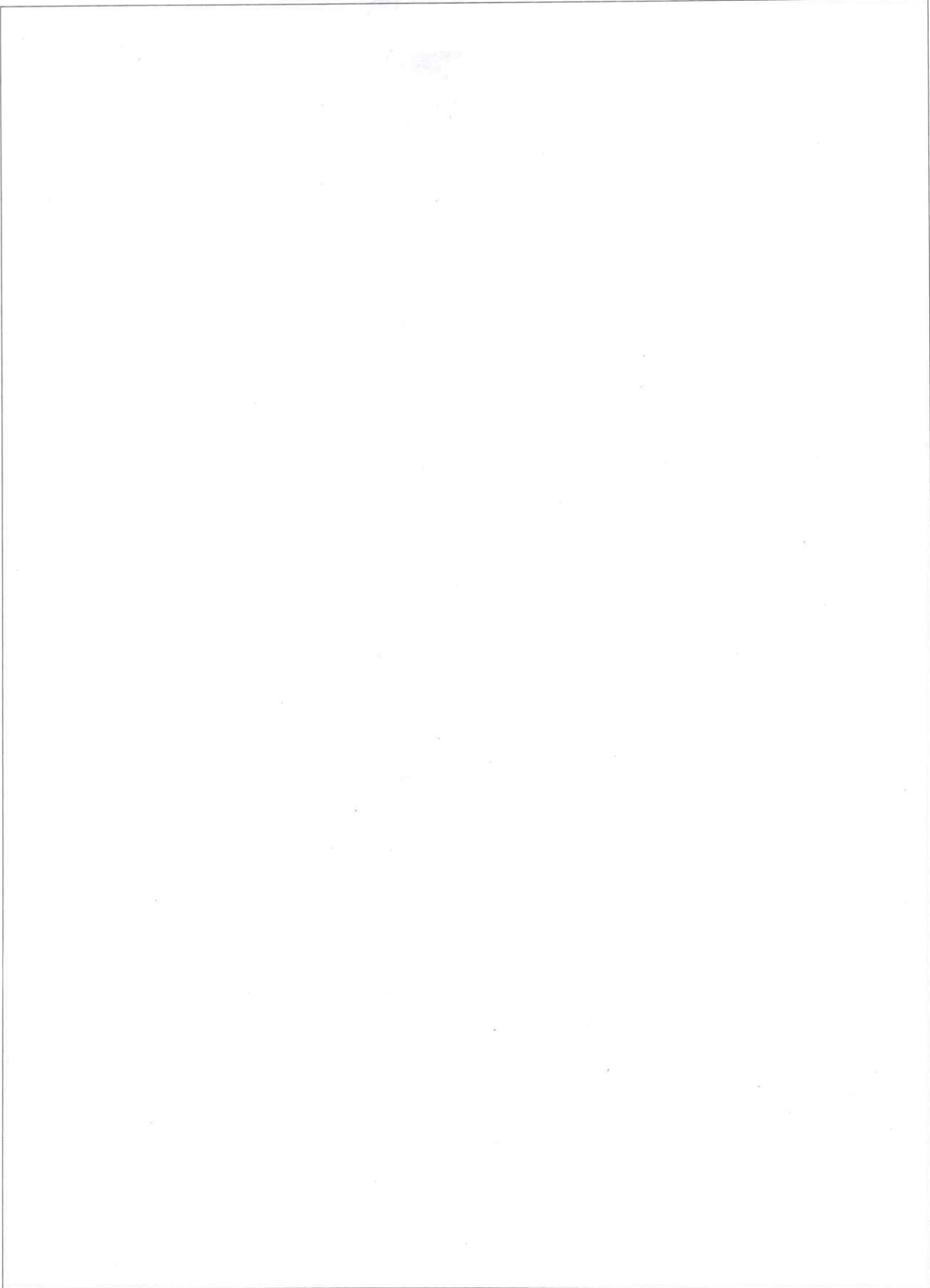
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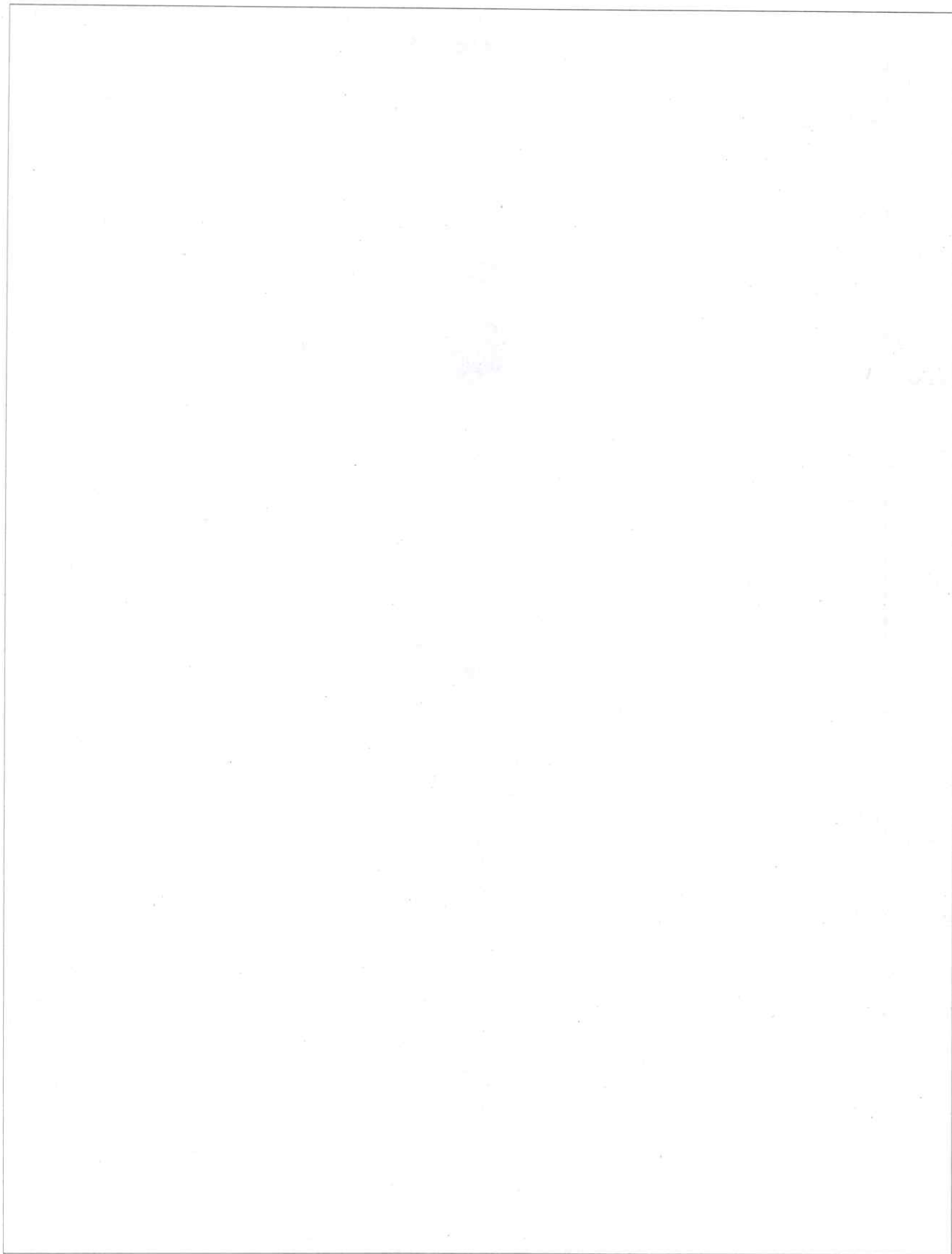
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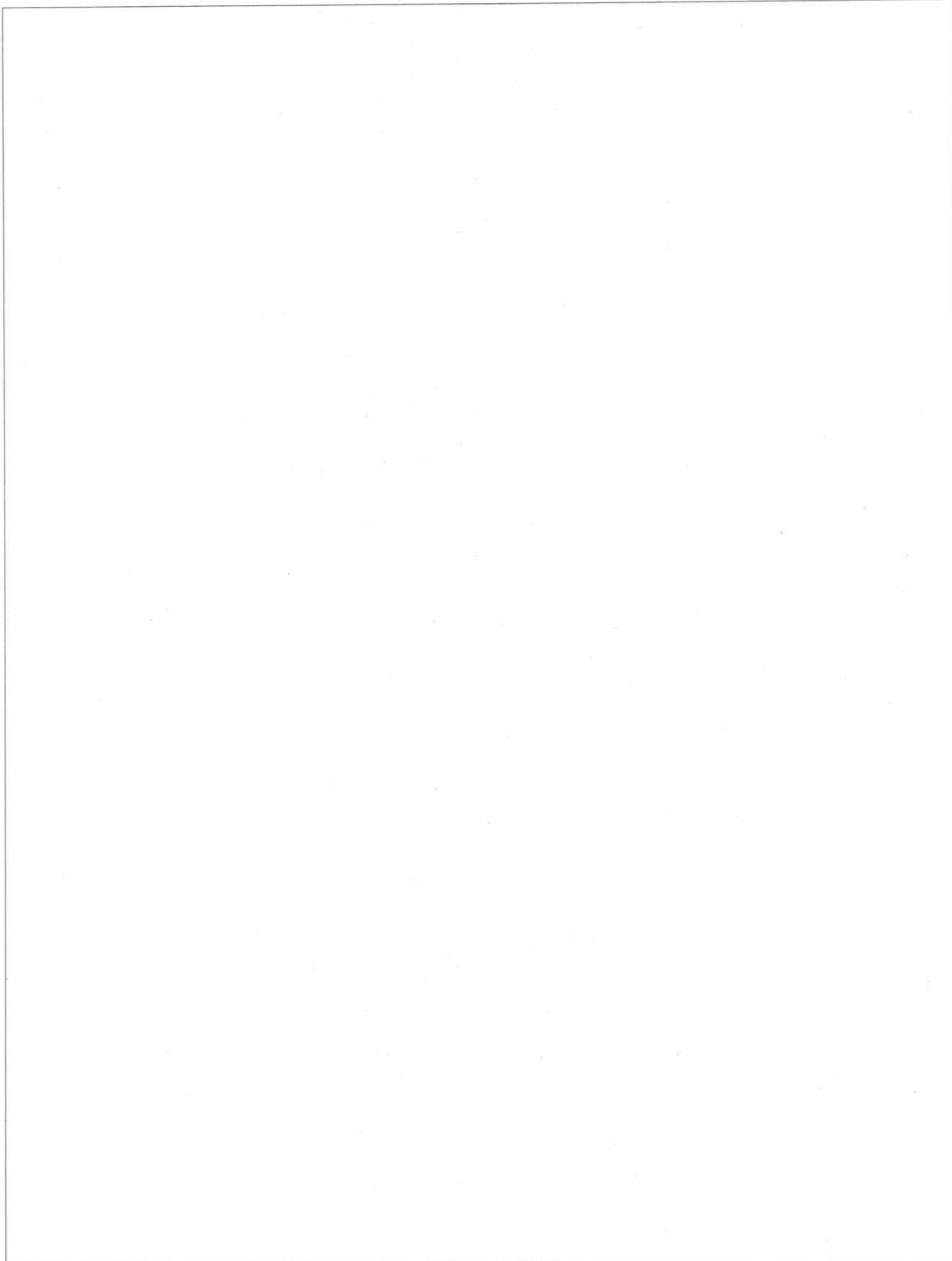
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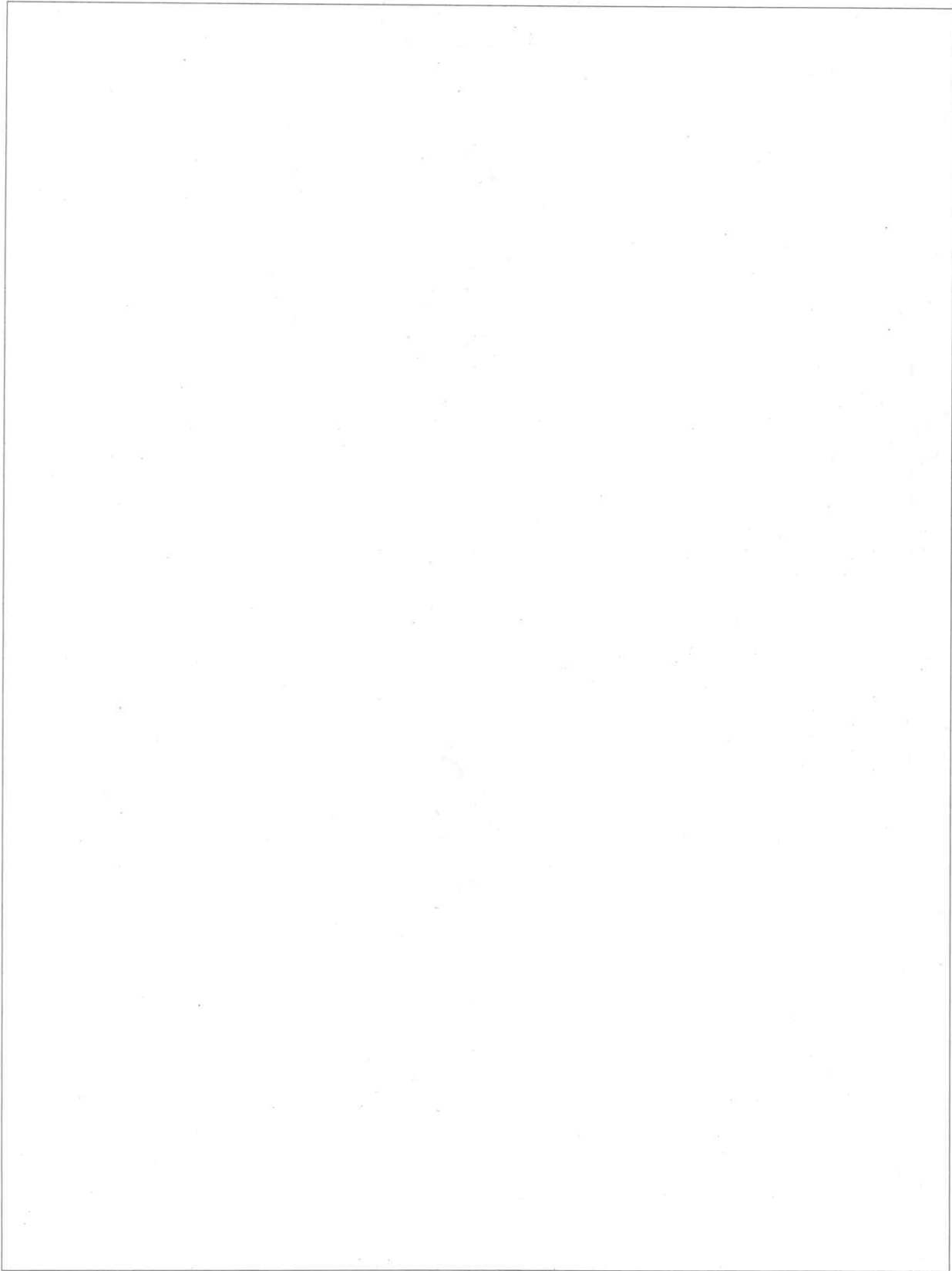
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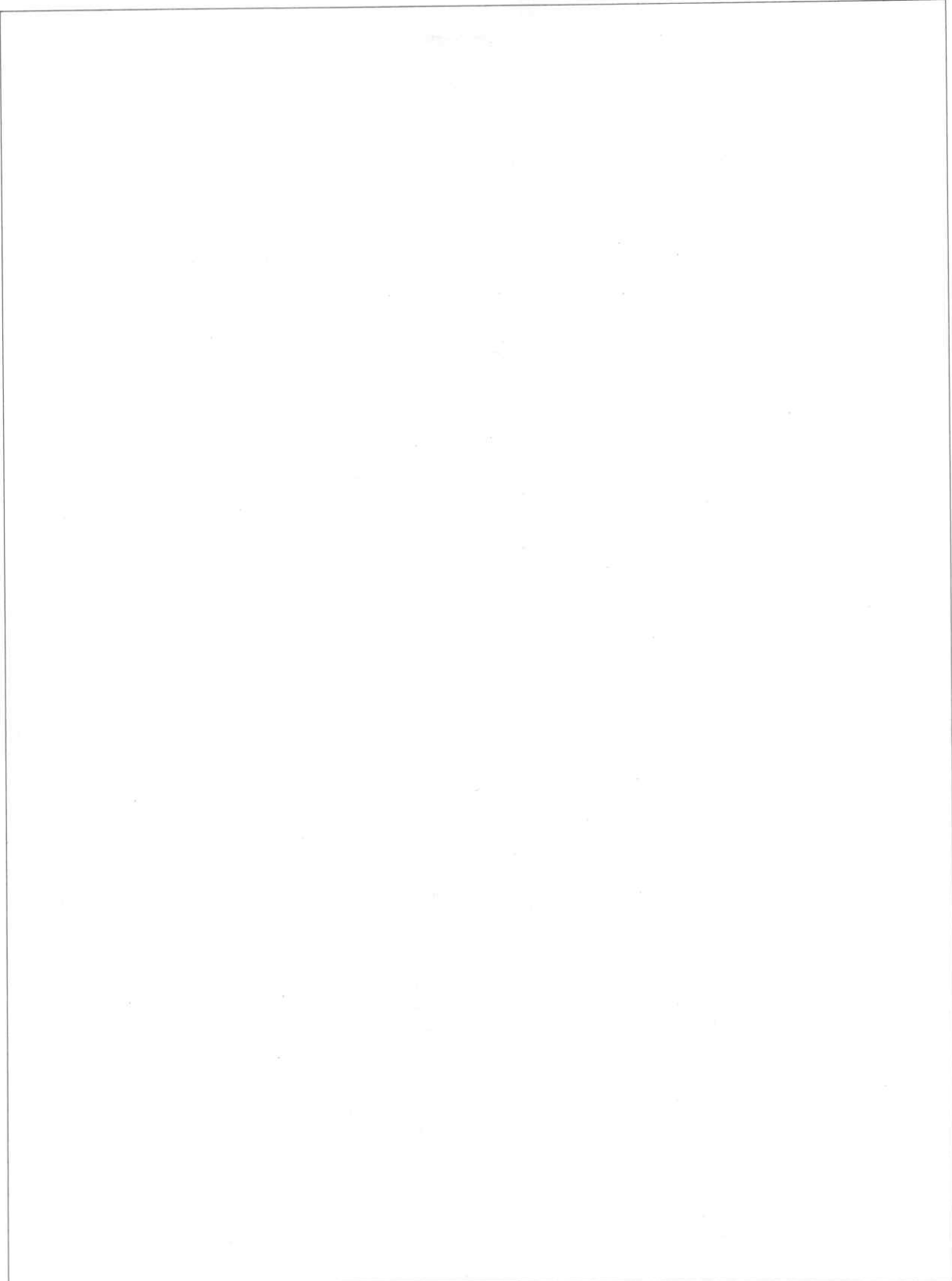
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